Module 8: Internal Controls/Fraud Detection and Prevention

Module Objectives

- Define internal controls, fraud and grants fraud
- Describe fraud schemes related to the Federally funded highway safety program
- Identify behavioral, process, and transactional red flags for fraud
- Describe key elements for fraud prevention and detection
- Describe fraud prevention strategies

Contents

Introduction 1
Module Objectives 2
Internal Controls 3
Fraud 9
Red Flags 14
Fraud in Federally Funded Projects 16
Prevention Strategies - SHSO 21
Prevention Strategies 23

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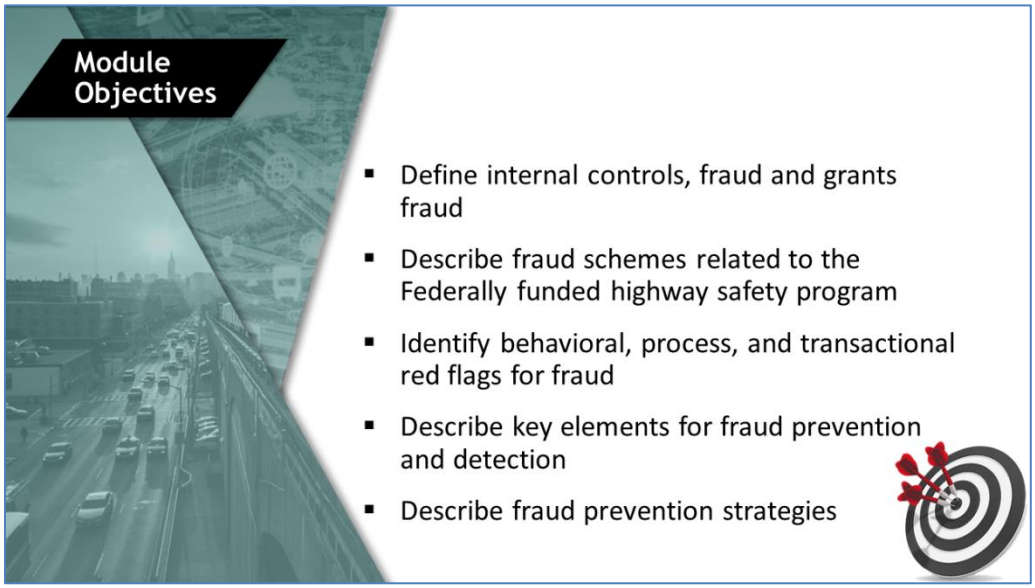
Introduction

Slide 1.

Module 8: Internal Controls/Fraud Detection and Prevention

Module Objectives



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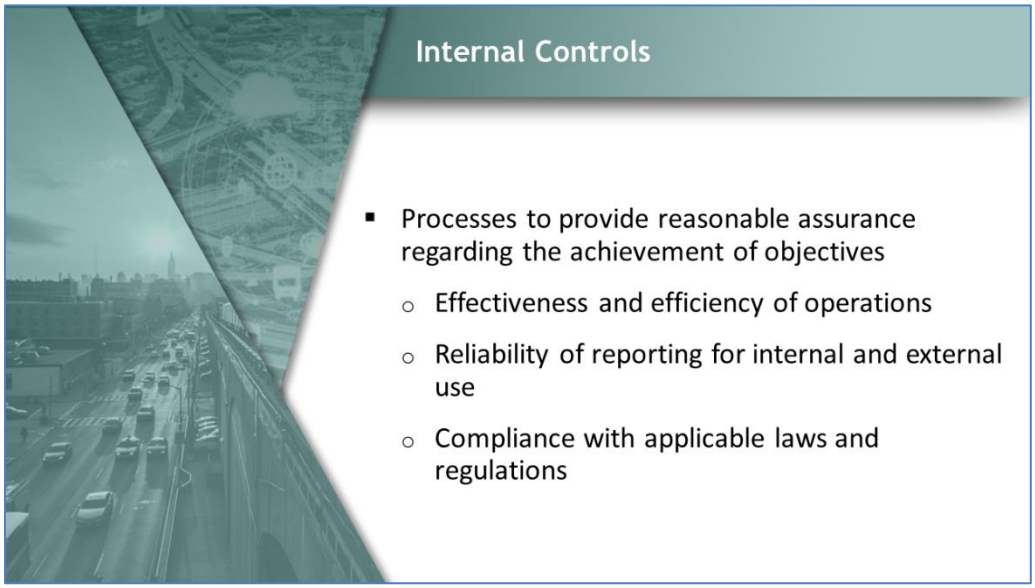
Internal Controls



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Internal controls help to ensure that management objectives are carried out and actions are taken to address risks.

Examples of internal controls include:

- Segregation of duties - having different people authorize, process, record and review payment vouchers

NOTE: Lack of segregation of duties is a frequent single audit finding.

Supplemental Materials

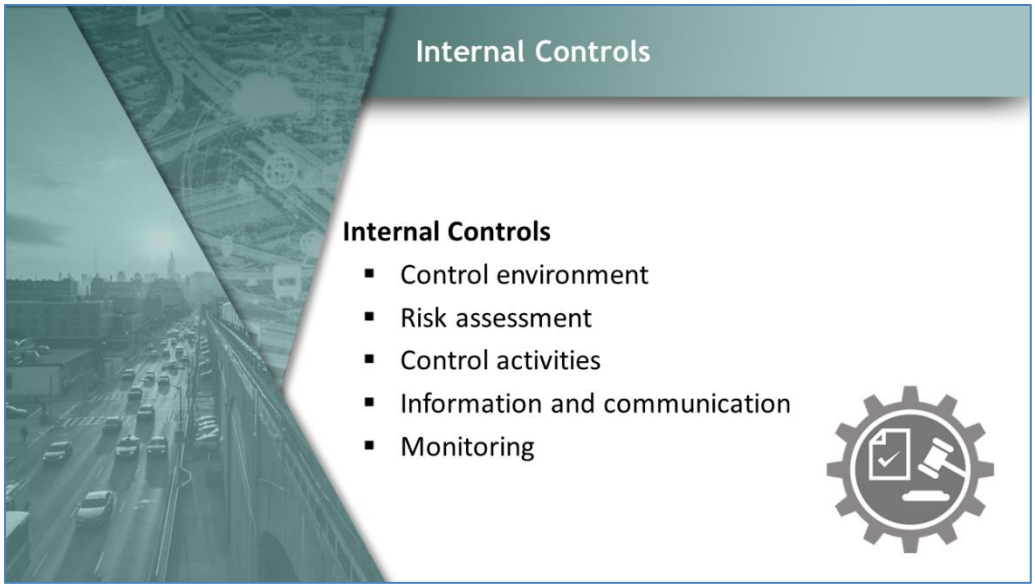
SUPPLEMENT: Single Audit Finding and Corrective Action Example

- Verifications – Using procedures that verify how correct grant amounts are calculated and awarded. While the definition noted in 2 CFR § 200.1 is specific to non-Federal entities, an example of verification is NHTSA's procedure that requires grant formulas, award calculations, and entries into GTS and USA Spending be verified by two or more people. (i.e. calculated by financial specialists, verified by program manager and Chief Counsel Office.)

USA Spending/USASpending.gov - is the publicly accessible, searchable website mandated by the Federal Funding Accountability and Transparency Act of 2006 to give the American public access to information on how their tax dollars are spent.

RESOURCE: USASPENDING.gov

RESOURCE: 2 CFR § 200.1



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Internal controls – Internal controls help ensure many things. Effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Without adequate internal controls, the likelihood that fraud will occur is much higher.

Internal controls take place on multiple levels.

For example: NHTSA has an overarching internal control process that includes all NHTSA offices. As one of the NHTSA Offices, Regional Operations and Program Delivery (ROPD) gets audited and evaluated for internal controls.

Thus ROPD, as administrators of grant funds, must have an internal control system to ensure that grant funds are administered and monitored, and risks are minimized.

Similarly, the SHSO may be in a similar situation, depending on where you are housed. You may be part of a larger internal control system, but still need to have an internal control system for managing grants.

2 CFR § 200.303 identifies responsibilities of non-Federal entities in developing and maintaining effective internal controls for Federal awards.

Additionally, five factors below should be considered in all internal control systems.

NOTE: Risk assessment and monitoring will be discussed separately as well.

Control environment - Sets the for good internal controls. There is an expectation that internal controls will be in place. Management should set a positive and supportive attitude toward internal controls.

The environment should reflect management's commitment to ethical, regulatory and organizational policies and the implementation of effective operating procedures. Also include a commitment to staff competence.

Risk Assessment - Ability to identify what could go wrong. Where are your staff and or subrecipients vulnerable, where are the weaknesses? We will talk about risk assessment and monitoring separately, for although they are part of internal controls systems, they are often considered as separate strategies. (check https://sam.gov/SAM/) Systems for Awards Management.

Control Activities – Help ensure SHSO directives are carried out, that objectives are being accomplished and project being implemented as planned. (examples – approvals, reconciliations, performance reviews, documentation that necessary activities have occurred, segregation of duties progress and final reports, policies and procedures)

Information and communication - Use effective communication methods such as inclusion in policies and procedures, management directives memos, internet webpages. This ensures everyone knows what is required.

Monitoring - Should be based on risk assessment, assess quality of agency performance over time, and ensure that findings of audits and other reviews are promptly resolved.

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Requirements for Non-Federal Entity

2 CFR § 200.303

- Non-Federal entity (SHSO and subrecipient) must:
  - (a) Establish, document, and maintain effective internal control over Federal award that provides reasonable assurance that the non-Federal entity is managing Federal award in compliance with Federal statutes, regulations and terms and conditions of Federal award

Slide 5.

Requirements for Non-Federal Entity

2 CFR § 200.303

- (b) Comply with U.S. Constitution, Federal statutes, regulations and the terms and conditions of the Federal award
- (c) Evaluate and monitor recipient's/subrecipient's compliance with statutes, regulations and terms and conditions of Federal awards

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Requirements for Non-Federal Entity
2 CFR § 200.303

- (d) Take prompt action when instances on noncompliance are identified
- (e) Take reasonable cybersecurity and other measures to safeguard information including protected, personally identifiable information(PII) and other information considered sensitive and confidential

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Website Resource

RESOURCE: 2 CFR § 200.303

Fraud often results when there is a lack of effective internal controls. Results can be devastating for both the individuals involved and the agency organization they work for. Fraud can result in loss of jobs, negative press, lack of confidence in the agency/organization and could ultimately affect agency/organization funding (refer to certifications that State and subrecipients must sign to receive grant funds).

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Fraud

Slide 8.

When we speak of suspected fraud, what do we mean?

An illegal act that involves obtaining something of value through willful misrepresentation. The operative word is willful.

Grants Fraud

Using Federal dollars for personal gain or in other ways than intended use.

Fraud typically falls into one of three categories.

Conflicts of interest - required to use Federal funds in the best interest of their program. Decisions on who to fund must be free of undisclosed personal or organizational conflicts of interest.

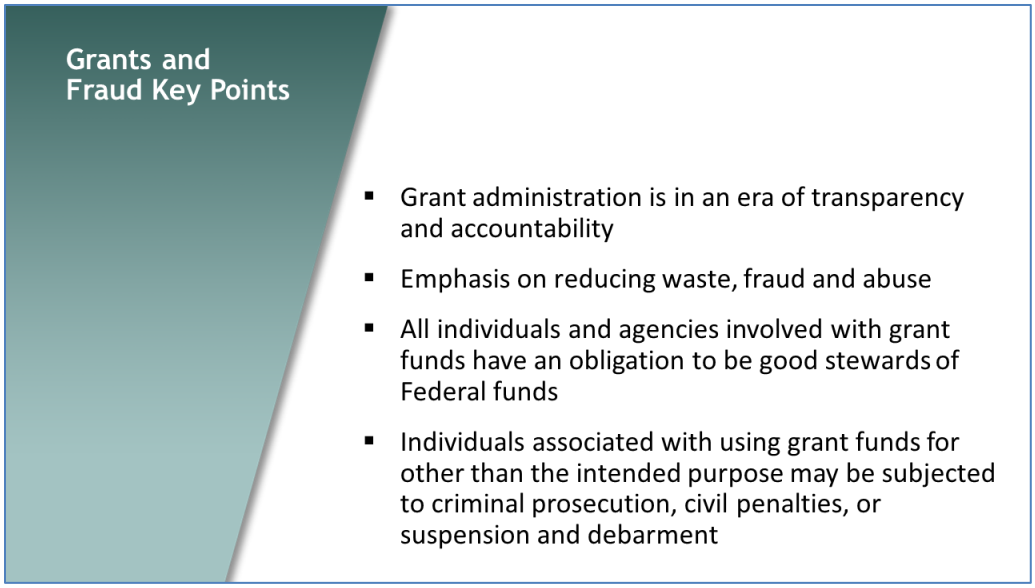
- Less than "arm's length" – purchasing goods or services (such as consultant) or hiring an individual from family or business associate of the recipient or sub
- Subaward decisions and vendor selections must done using fair and transparent processes

Making materially false statements (lying). Grants are legally binding, and recipients and subs are obligated to use their funds per the signed agreement, and act with integrity when applying and reporting use of funds. Also obligated to track use and maintain supporting documentation.

- Typical issues - Unilaterally redirecting funds for a purpose not stated in the agreement, provide false or misleading information in application or narrative and or financial reports (falsifying time sheets), presenting false claims
- Example that something may be wrong: inability to provide sufficient and verifiable supporting documentation concerning use of funds

Theft - People that embezzle funds can be very creative and often appear trustworthy and can remain undetected for long periods of time. Often a result of poor internal controls, particularly a lack of separation of duties.

- Funds diverted for personal gain by making fictitious transactions, misuse of credit card – pay off debts, weddings, college tuition etc.



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Emphasis on reducing fraud waste and abuse

Fraud, waste and abuse does occur. Fraud is often not easy to detect and can go unnoticed for quite some time.

Issues can range from poorly managed programs to intentional criminal fraud schemes.

All individuals and agencies involved with grant funds have an obligation to be good stewards of Federal funds.

Grant funds are awarded with a specific public purpose. Recipients and subrecipients must use those funds according to conditions specified in the grant. Recipients of Federal funds have the primary responsibility to ensure funds are used properly.

It is "our" job Federal and State to prevent fraud and detect and report suspected fraud. The actual fraud determination is made through the judicial or other adjudicative system. We are the detectives, not the judge and jury.

Individuals associated with using grant funds for other than the intended purpose may be subjected to criminal prosecution, civil penalties, or suspension and debarment.

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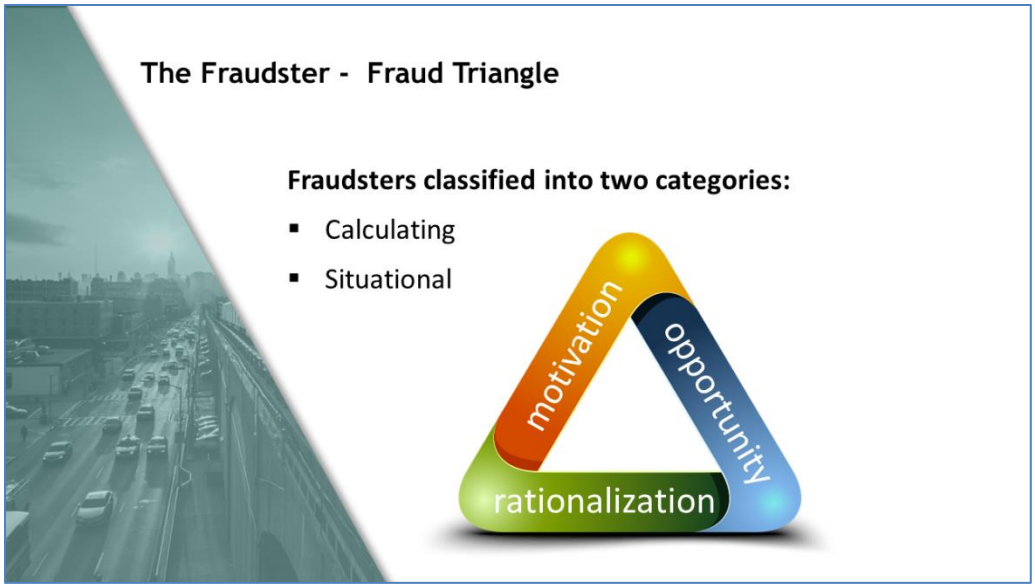

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Now that we have looked at what fraud is, let us look at the fraudster.

Fraudsters broadly classified into two categories: calculating or situational

- Calculating - pre-planned from the onset, plan to do something in the organization, on the lookout for an opportunity
- Situational - majority of fraudsters are situational reacting to pressure and opportunity
  - fraudsters have been with their organizations for 5-10 years and have trust of superiors and peers

SITUATONAL- FRAUD TRIANGLE

Motivation - Driven by a need or desire (greed). Many people have an opportunity to commit fraud, but only a small amount actually commit fraud i.e., accounting department employee experiencing financial hardships, develop taste for expensive lifestyles.

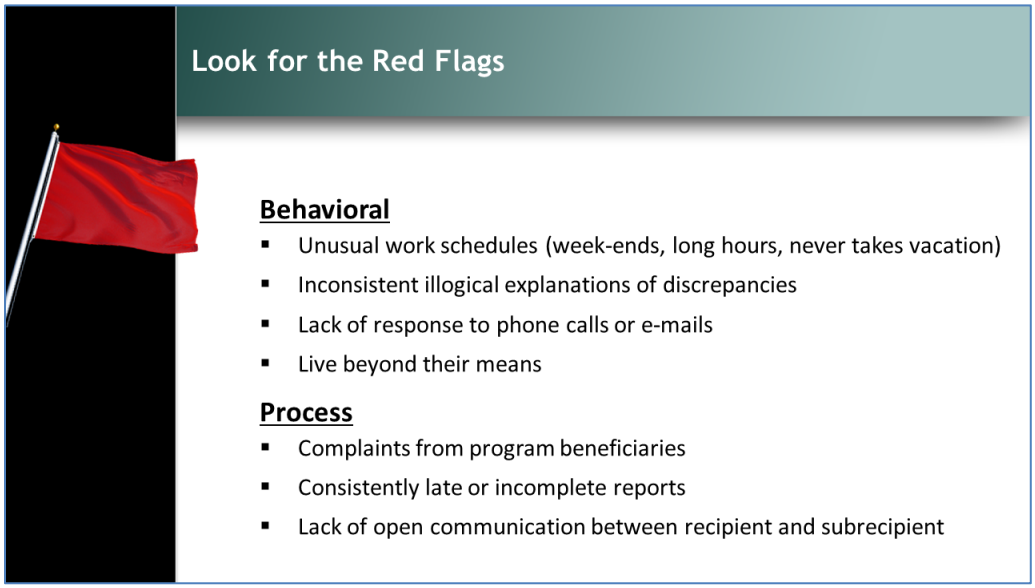
Opportunity - Seizing the moment. Many are swayed by the opportunity i.e., usually approving invoices and paying vendors is done by two different people. Employee 1 goes on extended sick leave and employee 2 is asked to cover his duties. Now there is no segregation of duties. Employee sees an opportunity to get some extra cash by. Overstates payments to vendor in his company's journal, pays vendors the actual amount and pockets the difference. Opportunity is more prevalent with weak internal controls and little of exposure.

Rationalization - Self justification for actions. Justification often relates to job dissatisfaction, perceived entitlement (was passed over for promotion with a higher salary) or saving or paying for possessions or special events (weddings, college tuition), gambling debts.

In the end the fraudster feels the gain outweighs possible detection.

Grant fraud can result in prosecution of criminal actions, civil fraud remedies or administrative actions such as suspension and debarment, cancellation of current or future grant awards.

Red Flags



Slide 11.

What are some of the red flags or risk factors that could indicate FRAUDULENT activity? Red flags are not necessarily indicative of fraud, it could be the result of poor management, uneducated staff or lack of training, but they should put you on the alert, especially if they persist over time.

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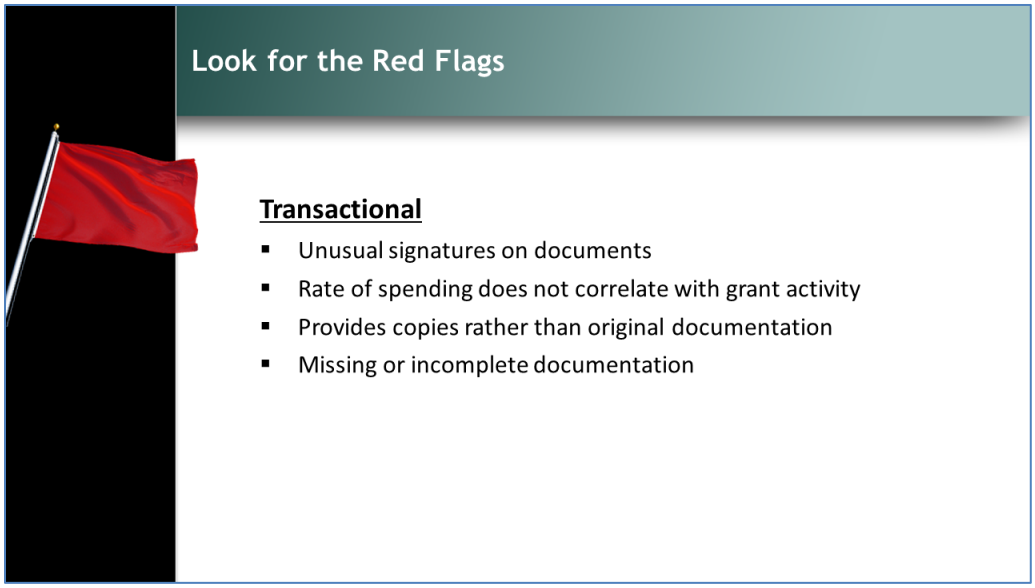

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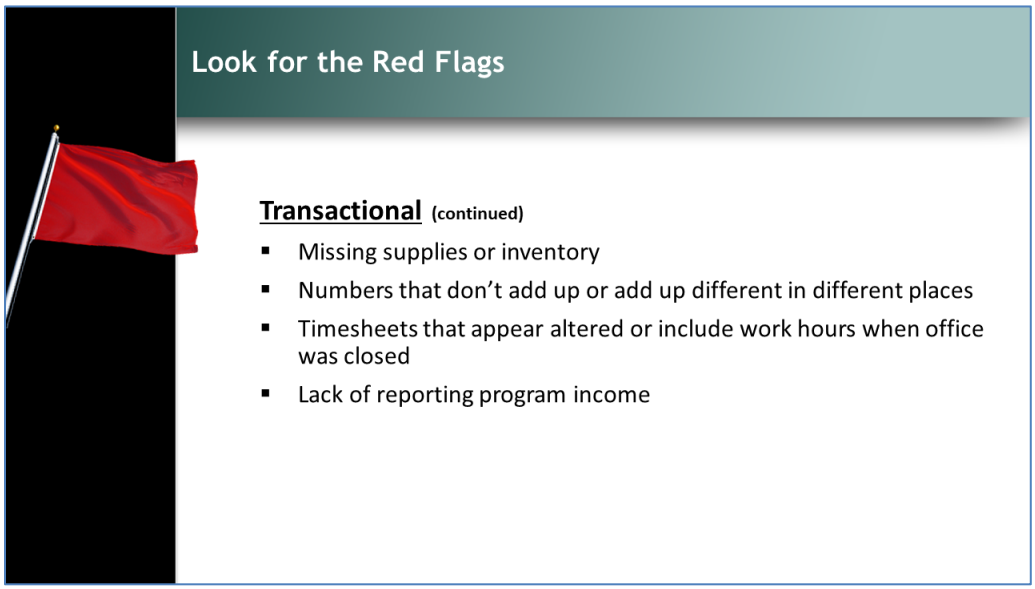

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Fraud can be detected by anyone.

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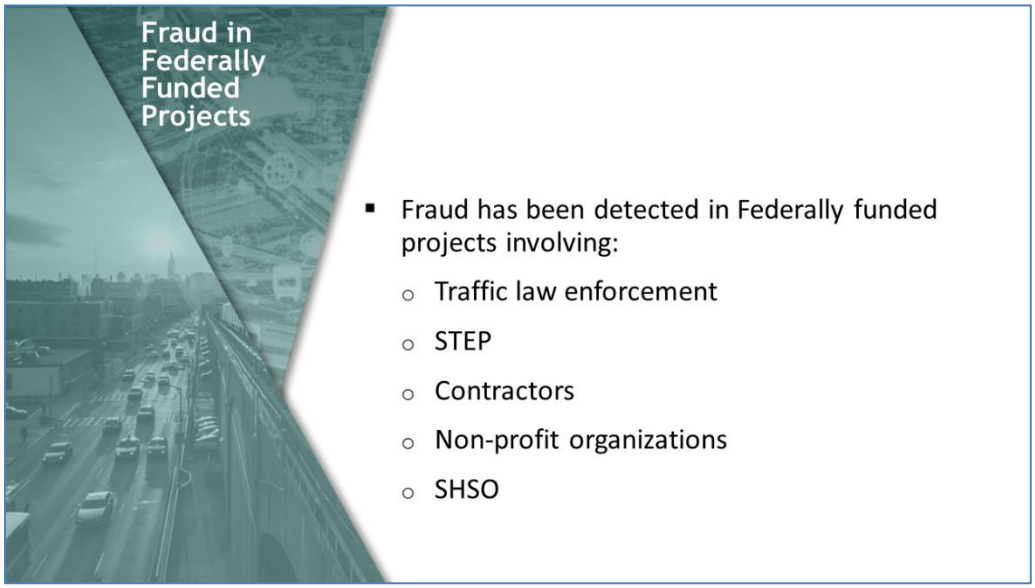
Fraud in Federally Funded Projects



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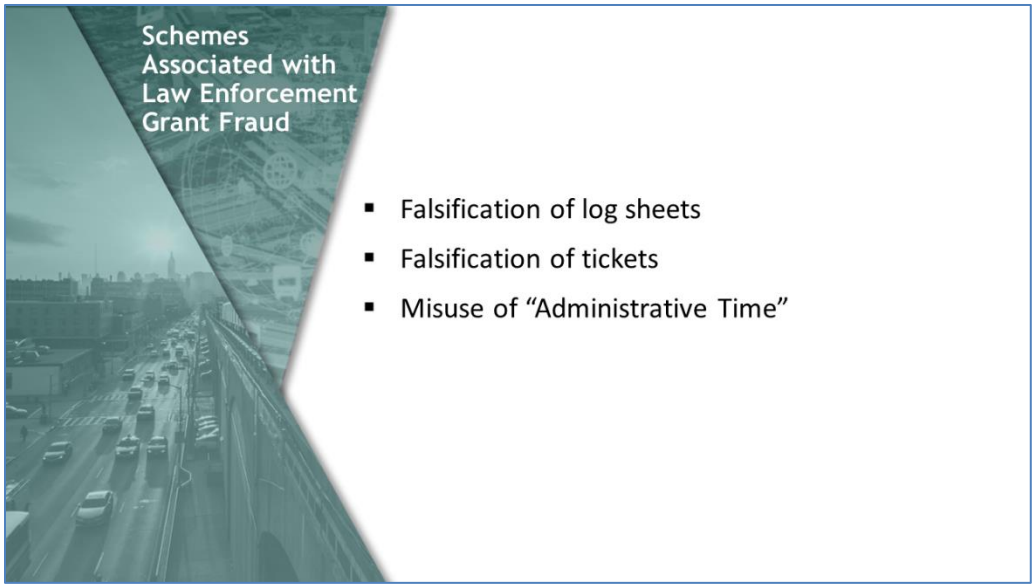
NOTE: STEP = Selective Traffic Enforcement Program



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Falsification of Log Sheets

- Fraud pertaining to an officer's log sheets of time worked is often initially discovered when it is reported by other police officers
- Officers misreport the number of hours worked, the time that the tickets are written, and the number of tickets written – in effort to get paid for time not worked
- This is confirmed/discovered when officers' log sheets are compared to actual time worked - based on dispatch logs, ticket records and vehicle logs

Falsification of Tickets

- Times omitted or made up
- False names or names of other unrelated violators
- Court system dismisses cases, reveals no tickets written

Misuse of Administrative Time

For example: Officers routinely added 1-2 hours to their time worked at the end of their shift for work not performed.

In some cases, there was no timed worked at all.

Strong supervision will help prevent this type of fraud.

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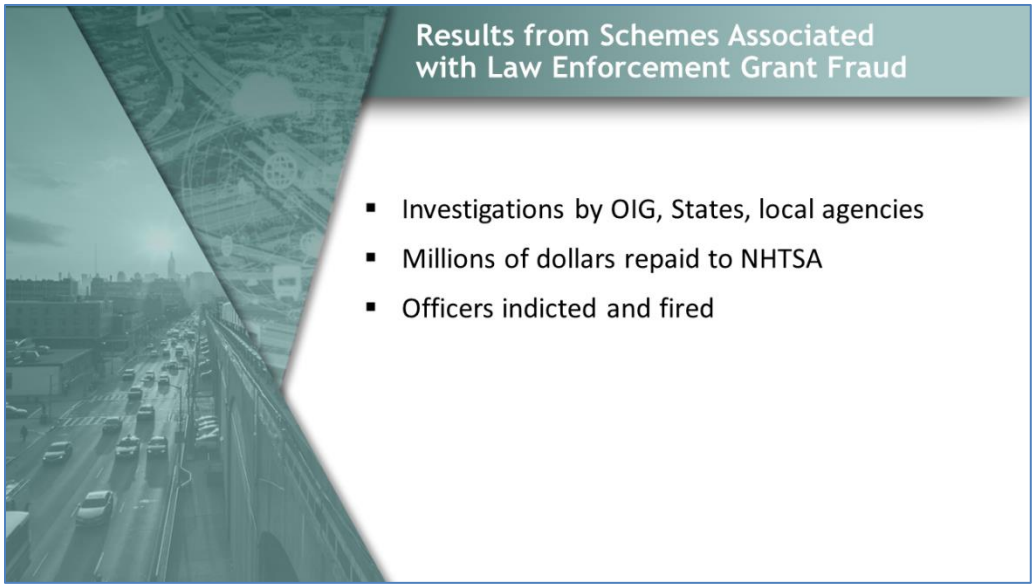
Results from Schemes Associated with Law Enforcement Grant Fraud
Investigations by OIG, States, local agencies
Millions of dollars repaid to NHTSA
Officers indicted and fired

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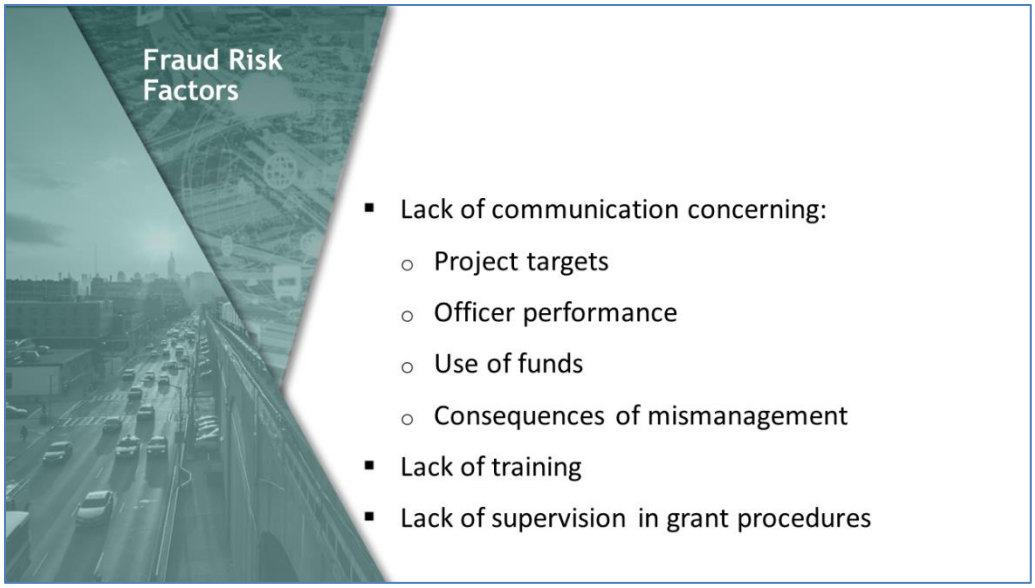

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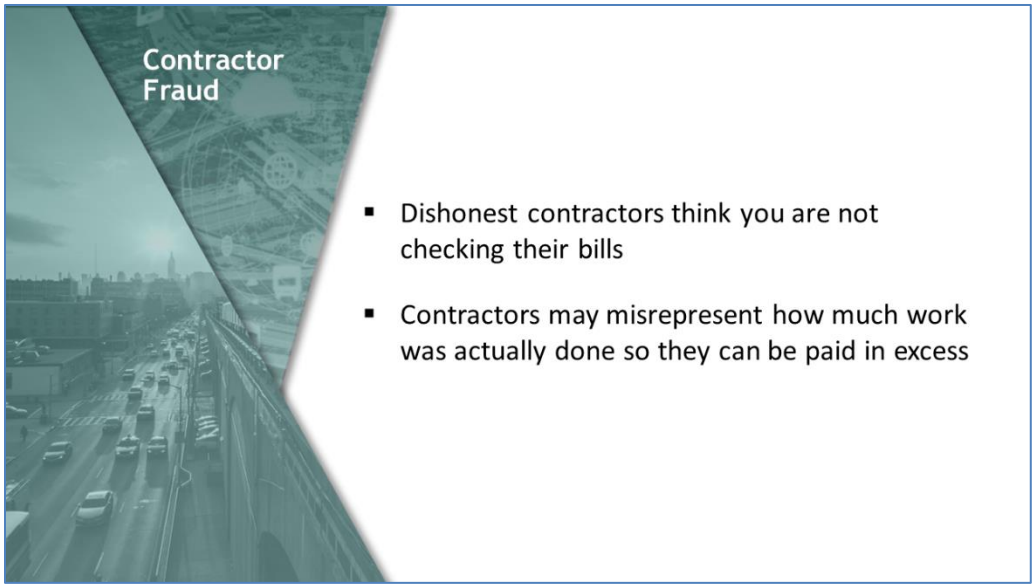
Source: OIG report to NHTSA:

- **Communication failure** - Between NHTSA, SHSO and the subrecipient was inconsistent and limited. Most was administrative in nature, and not about program management and stewardship. More about paperwork in order, and not about underlining performance. Oversight responsibility not appropriately outlined.
- **Training** – Departments with problems did not formally train their officers on the differences of the program from their normal shifts or of the consequences of mismanagement. Supervisors interviewed did not know how to manage a grant program, or monitor for fraud or abuse.
- **Building Supervision into Grant Procedures** – The single most important element for preventing fraud is the effective monitoring of officers working grant overtime. Strong departments had plans for supervision of officers working the grant. Sergeants working the same shifts and spot-checking paperwork improved completeness, as did a strong chain of command and no assumption that grant shifts would work the same as standard overtime or traffic shifts.



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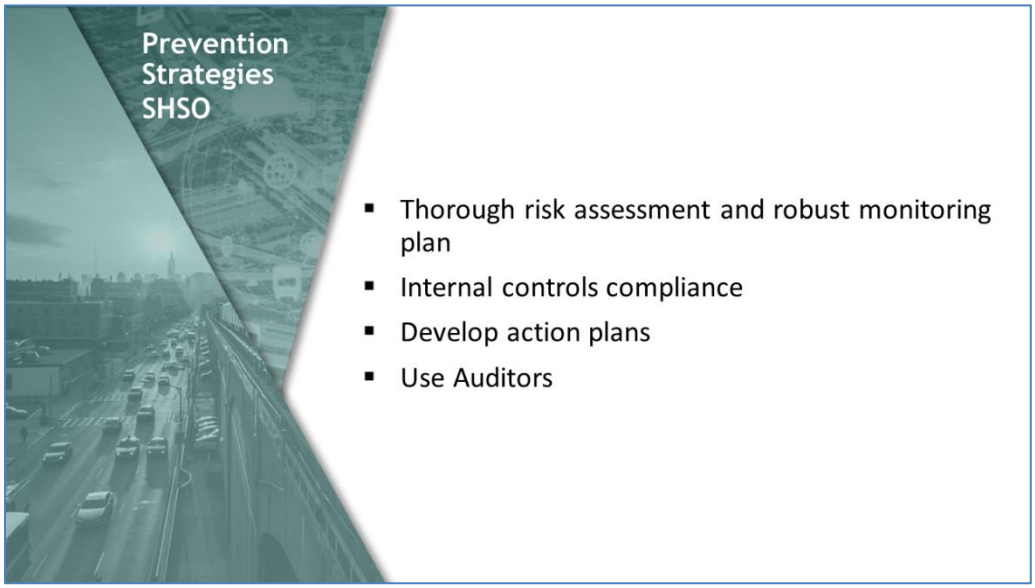
Fraud Example: Time Overcharging:

A grantee misrepresents the distribution of employee labor in order to charge for more work hours, or a higher overhead rate to increase profit.

Examples include: Claiming time for periods of work that have not occurred during the hours claimed, or over charging for administration time when no administration time occurred.

Prevention Strategies - SHSO



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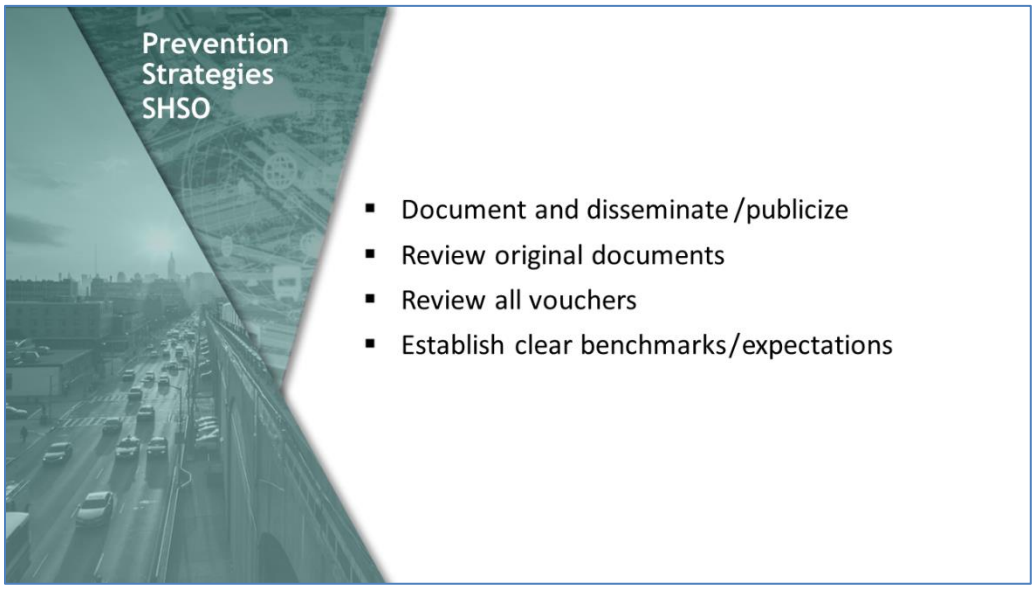

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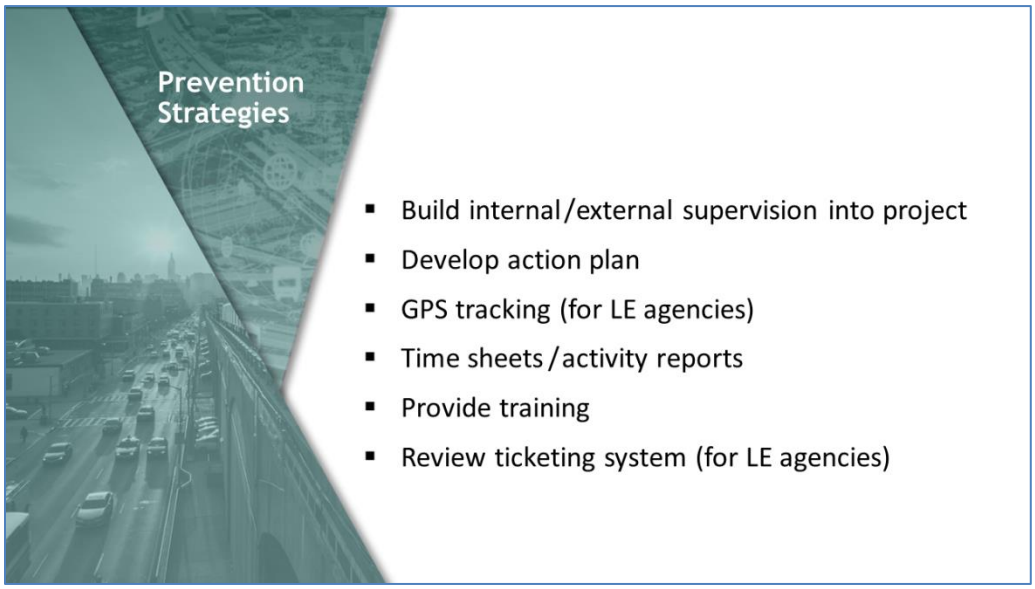
PREVENTION STRATEGIES – SHSO

- Thorough risk assessment and robust monitoring plan
- Require subrecipients to submit policy and procedure/internal controls to certify compliance
- Develop an action plan to follow when possible fraud is detected

- Use State auditors to randomly audit subrecipients and follow up allegations of fraud
- Document and disseminate summaries of identified fraud and the consequences to officers and project personnel, as a deterrent
- Voucher review:
  - Review original documents as opposed to copies or consolidated billing statements, whether at the subrecipient or subcontract level
  - Review all vouchers
  - Establish clear performance benchmarks and expectations
- Have SHSO and subrecipients develop internal Standard Operating Procedures outlining fraud prevention steps

Prevention Strategies



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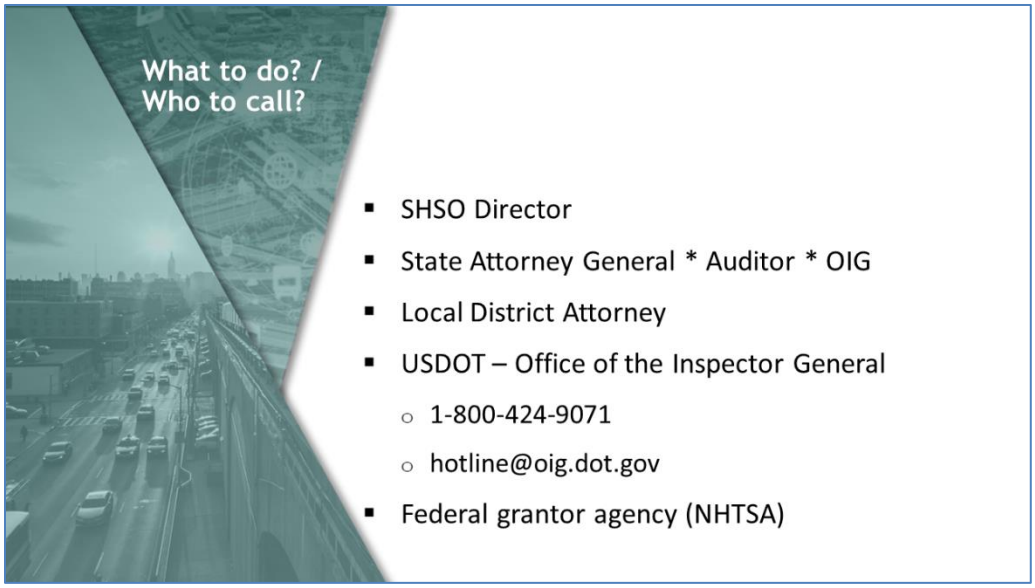
PREVENTIVE OVERSIGHT

- Build supervision into project
- Develop and implement an enforcement or project action plan based on data
- Use GPS units on patrol vehicles (for LE agencies)
- Use of time sheets and activity reports
- Provide training
- Review ticketing system - electronic vs. handwritten (for LE agencies)



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Follow State procedures – SHSO action plan or protocol.

Include a process for orienting the investigators on the highway safety program and regulations.

Inform the grantor agency (NHTSA) – early in the process and often.

Stay apprised of the investigation.

Report results and information for possible Federal disbarment action.

OIG – Office of the Inspector General

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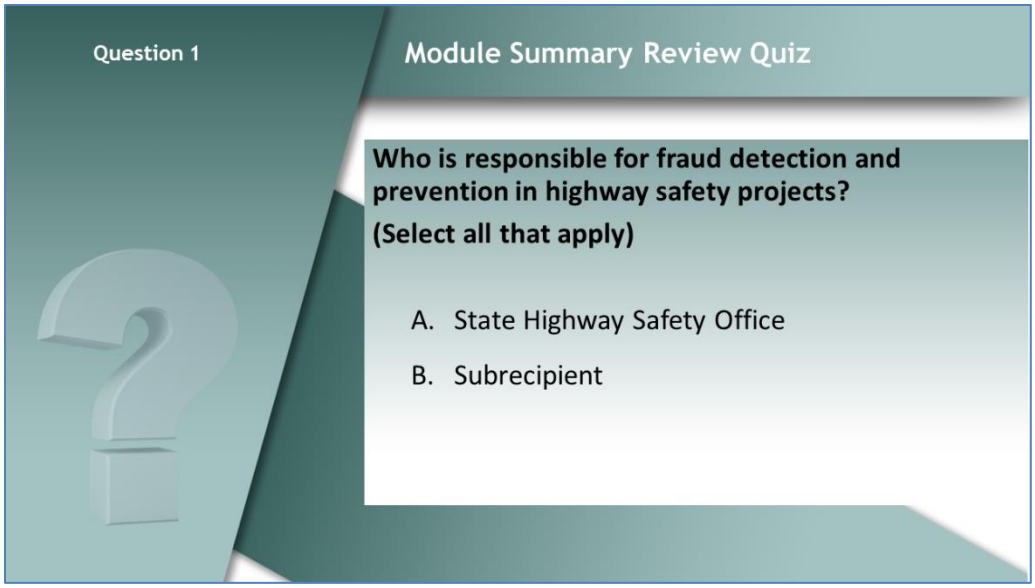
Question 1
Module Summary Review Quiz
Who is responsible for fraud detection and prevention in highway safety projects?
(Select all that apply)
A. State Highway Safety Office
B. Subrecipient

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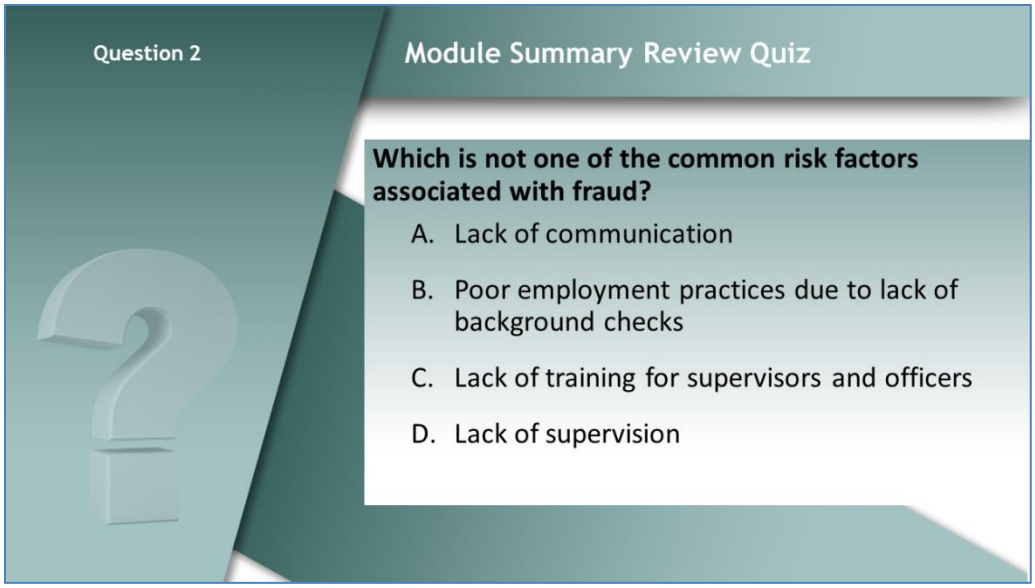
Question 2
Module Summary Review Quiz
Which is not one of the common risk factors associated with fraud?
A. Lack of communication
B. Poor employment practices due to lack of background checks
C. Lack of training for supervisors and officers
D. Lack of supervision

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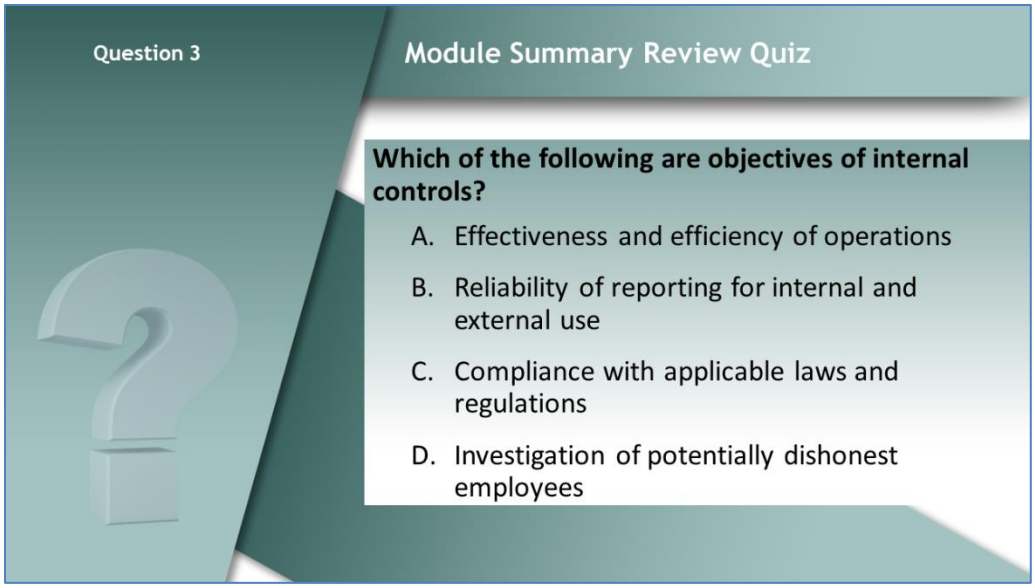
Question 3
Module Summary Review Quiz
Which of the following are objectives of internal controls?
A. Effectiveness and efficiency of operations
B. Reliability of reporting for internal and external use
C. Compliance with applicable laws and regulations
D. Investigation of potentially dishonest employees

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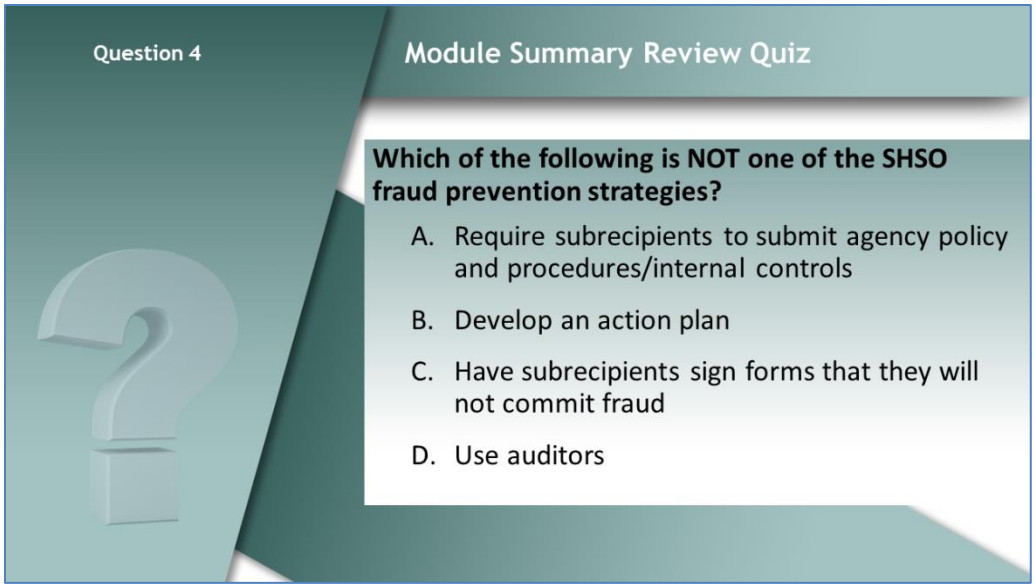
Question 4
Module Summary Review Quiz
Which of the following is NOT one of the SHSO fraud prevention strategies?
A. Require subrecipients to submit agency policy and procedures/internal controls
B. Develop an action plan
C. Have subrecipients sign forms that they will not commit fraud
D. Use auditors

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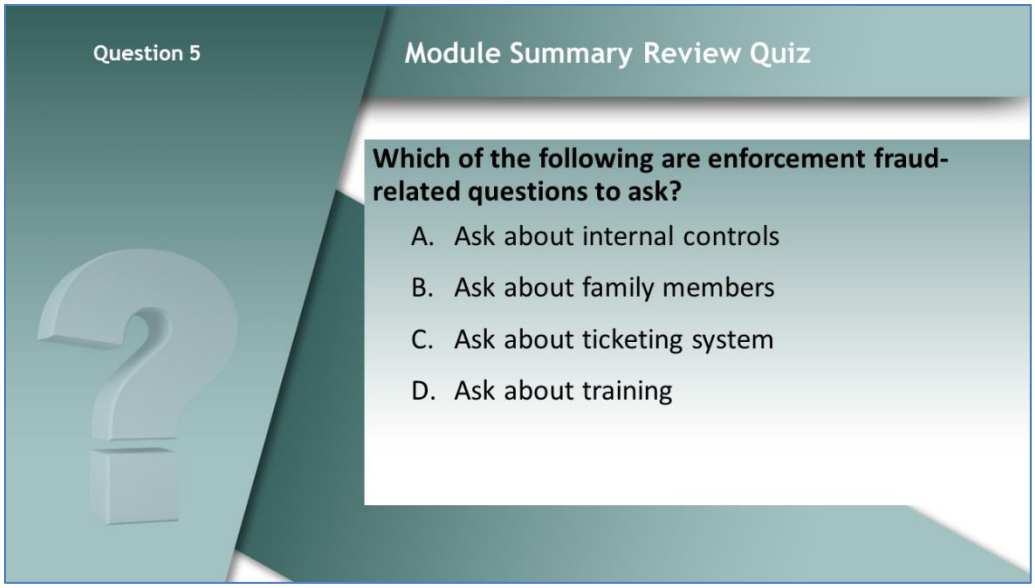
Question 5
Module Summary Review Quiz
Which of the following are enforcement fraud-related questions to ask?
A. Ask about internal controls
B. Ask about family members
C. Ask about ticketing system
D. Ask about training

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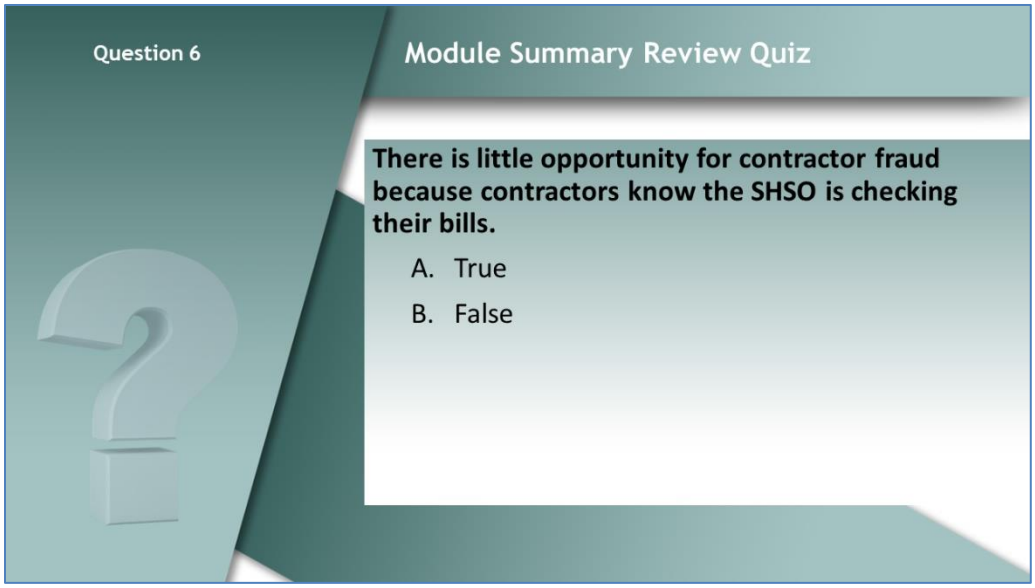
Question 6
Module Summary Review Quiz
There is little opportunity for contractor fraud because contractors know the SHSO is checking their bills.
A. True
B. False

Slide 29.