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Internal Controls BULLETIN

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Anatomy of an internal control failure

Highlights

- Risk assessment helps management understand where they should look to prevent fraud.
- A knowledgeable oversight body that monitors the effectiveness of internal controls makes the difference.
- A strong control environment, where management demonstrates a commitment to integrity and ethical values, is fundamental to effective internal control and fraud prevention.

We have all heard the stories. An employee from inside an organization gets caught red-handed stealing money. The investigation reveals a fraud that began several years ago. Millions of dollars are missing. The evening news sensationalizes the scandal as a lengthy and expensive public trial unfolds.

This was the case with the Department of Public Works for Adams County, Colorado. The fraud involved the department and a business called Quality Paving. Public Works leadership rigged the bidding process to award road repair contracts to Quality Paving. Once Quality Paving had the contracts, Public Works officials approved price increases through contract change-orders. In exchange, officials had free work done on their homes and received gifts. An investigation even found, in some cases, the county paid Quality Paving for work that was never performed.

What could the Adams County government officials have done differently that would have changed what happened? Performing risk assessments, adequately monitoring the internal control system, and promoting a strong control environment could have helped.

Doing risk assessments helps management understand where they should look to prevent fraud. A risk assessment would have revealed the dangers of third-party contracts in the public sector. It could have led Adams County to put controls in place designed to prevent fraud, waste, and abuse. Control activities like segregation of duties, documented approvals, and spending authority limits prevent fraudsters from manipulating the system for their own gain.

Monitoring the system of internal control is another point where things might have ended differently. County leadership stated that they were not the technical experts when it came to public works contracts, so they never questioned them. They blindly trusted Public Works management, which allowed the managers to continue their fraud. Knowledgeable leaders who understand the importance of monitoring the effectiveness of internal controls and who are not afraid to ask questions could have made a difference in Adams County.

The most important contributor to the Adams County case was the culture that leadership fostered. “Tone at the Top” is how leadership promotes an ethical culture and good employee behavior. In the case of Adams County Public Works, the organization’s culture was flawed. All the controls in the world will not stop a fraudster if leadership ignores or goes around key controls. A strong control environment, where management demonstrates a commitment to integrity and ethical values, is fundamental to effective internal control and fraud prevention.

Suggested action steps: Consider the Adams County fraud. Think about risk assessment, monitoring, and culture in your own work area. Is there a potential for fraud? If you suspect fraudulent activity is happening, report it through your agency’s fraud reporting channels or to the Office of the Legislative Auditor.

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