



## Tackling the “Fraud Triangle” Part 2 of 3 YOUR FISCAL RESPONSIBILITY

There may be many individuals within your Fire District or VFD that have a role in fiscal responsibility – which includes following a strong internal control process for petty cash, assets and other money collections. Individual fiscal responsibilities may vary within the organization and, therefore, clearly written policies and procedures should be approved by your Officers/Governing Members and shared with all employees and volunteers.

Leaders within your organization are ultimately responsible for the appropriate use and control of the funds and assets entrusted to the organization. With that in mind, when it comes to petty cash funds, donations, gifts and collections it is highly recommended that cash/check receiving, handling and allocation functions of the organization be centralized to the extent possible and a strong internal control environment maintained.

### What is “INTERNAL CONTROL”?

- **Internal control is a process** where the goal is to maintain reliable financial reporting in the most effective and efficient manner while also maintaining compliance with any/all applicable laws and regulations.
- **Internal control is affected by people** and their actions at all levels of the organization. Policies and procedures are important, but the actions of the people entrusted to follow and carry out the fiscal responsibilities spelled out within the policies and procedures are paramount.

### How is internal control achieved?

A strong internal control process involves both preventive controls and detective controls.

Regarding fiscal responsibility, **preventive** controls attempt to prevent or deter acts of fraud from occurring in the context of tackling the fraud triangle. These controls are proactive in nature and designed to prevent a loss, error or omission. Some key examples of preventive controls are:

- **separation of duties**
- **proper authorizations**
- **adequate documentation**
- **physical security** over cash and other assets

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Although prevention is the primary objective, your Fire District or VFD will still need to monitor activities and implement **detective** controls. Detective controls are intended to detect (again in the context of tackling the fraud triangle) thefts or acts of fraud that have already taken place. In the event preventive controls have failed, it is vital that your organization is able to garner evidence of the theft or fraud after the fact. Unfortunately, detective controls will not necessarily prevent this type of activity from recurring. Some key examples of detective controls are:

- Regular **supervisory review** of bank account activity, reports and reconciliations
- Routine **spot-checking** of transactions, records and reconciliations (do things make sense and look reasonable)
- **Variance analysis**
- **Physical inventories**
- **Internal audit** and review of controls

### **What makes a strong and effective control environment?**

A strong control environment is one that supports ethical values and sound business practices. Your leadership team is responsible for “setting the tone” for the organization and encouraging the highest levels of integrity and ethical behavior. Individuals at this level must exhibit leadership behavior that promotes internal control and accountability.

These individuals are responsible to:

- **Communicate to employees and volunteers that fraud and any conflicts of interest will not be tolerated.**
- **Communicate to employees and volunteers that your policies and procedures are important and will be followed.**
- **Make employees and volunteers fully aware of their responsibilities, including internal controls.**
- **Monitor the internal controls system on an ongoing basis.**

Segregation of duties is essential to an effective internal control environment. When fiscal responsibilities are segregated, there is a reduction in the risk of fraud and accidental appropriations. This control measure is considered a deterrent to fraud. In essence, one individual should not have responsibility for the actual handling of money, recording receipt of money and reconciliation of bank accounts. A system of checks and balances is critical and can be accomplished through segregation of duties.

In certain circumstances it may be difficult to separate these duties – given manpower or other financial constraints. In cases where segregation of duties cannot be fully achieved, increased and detailed, supervisory review of all related activities and transactions is needed as a compensating control activity. Explanations for any unexpected results or unusual transactions should be obtained. Documentation of all reviews and **reconciliations** should be maintained.

For further discussion of internal controls, the red flags for fraud and best practices to safe guard your petty cash fund, donations, gifts or collections and assets read *Tackling the “Fraud Triangle” part 3* in this series.

