

Division of County Audit

Trustee's Responsibility to Detect and Report Fraud, Waste, and Abuse

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(The following statements represent the Division of County Audit's understanding of the Trustee's responsibilities based on various state statutes and years of audit experience involving the Office of Trustee. They are intended as a training tool to assist Trustees in making informed judgments about their responsibility to detect and report fraud, waste, and abuse. These statements are not intended as legal advice.)

1. Along with all other local government officials, Trustees have a statutory responsibility to report Fraud, Waste, and Abuse, Section 8-4-503, *Tennessee Code Annotated*. Trustees are not required to report Fraud, Waste, and Abuse unless information about these matters comes to their attention (i.e. the Trustee has knowledge of a fraud or alleged fraud from an available source). Trustees are not required to search out that information. Neither are they required to be an expert in detecting matters of fraud that might be associated with information processed through their office. Fraud by its very nature is intentionally concealed, and therefore; difficult to detect.

Consider disbursements (i.e. paid warrants/checks). Trustees are not required by statute or by fiduciary responsibility to audit paid warrants/checks. State statutes do require Trustees honor warrants/checks when monies are available and failure to do so is a Class C misdemeanor and grounds for removal from office, Section 8-11-105, *Tennessee Code Annotated*.

In addition, Trustees generally do not have means to detect disbursement fraud. For example, one method to uncover fraud is to examine endorsements on paid warrants/checks. Most Trustees no longer physically examine paid warrant/checks because of electronic reconciliation processes. Trustees are not required to physically examine paid warrants/checks or review endorsements. Furthermore, some banks no longer provide that information. When endorsement information is provided, the information is often illegible. Even if Trustees examined endorsements on every warrant/check presented to their offices, they probably would not be able to detect existing fraud because they are often unfamiliar with fund budgets or who represents legitimate vendors/employees, not to mention the difficulty involved in identifying forged signatures and endorsements. Auditors from the Division of County Audit are hindered by these same issues. In spite of these obvious limitations, Trustees have been responsible for uncovering major frauds.

2. Trustees have a fiduciary responsibility to properly collect, record, deposit, invest, and allocate receipts and disbursements in a timely fashion. Trustees also have a fiduciary responsibility to protect the assets that are under the control of their office. Trustees have sworn an oath to follow laws such as the three-day deposit, bank collateral, investment, and surety bond laws, etc. All of these laws were designed to protect against the loss of public assets. In a similar way, Trustees have a fiduciary

responsibility to take reasonable steps to eliminate the opportunity to commit fraud within their office. This can be accomplished by establishing appropriate internal controls. However, there is no such thing as perfect internal controls that eliminate the possibility of fraud or guarantee fraud will be prevented or detected. Remember the fraud triangle. Frauds require a Rationalization, an Opportunity, and an Incentive. Internal controls are about reducing Opportunity.

3. What is Waste and Abuse? Accounting Standards do not define waste but they do define abuse. Waste and abuse are terms that are often associated with grant activity. The definitions of waste and abuse are similar. One definition of waste is “the extravagant, careless, or needless expenditure of government funds, or the consumption of government property, that results from deficient practices, systems, controls, or decisions.” Waste does not necessarily involve fraud, or noncompliance with provisions of laws, regulations, contracts, or grant agreements.

Abuse is defined in accounting literature as behavior that is deficient when compared to behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes the misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, or noncompliance with provisions of laws, regulations, contracts, or grant agreements.

Both definitions are subjective. What one person considers waste, another might consider necessary. Therefore, we recommend restraint when reporting waste and abuse unless the situation is obvious and egregious.

4. Trustees can obtain a Fraud Reporting Form by using the link to the Division of County Audit on the Comptroller’s website
<http://www.comptroller1.state.tn.us/ca/fraudreport.asp>

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