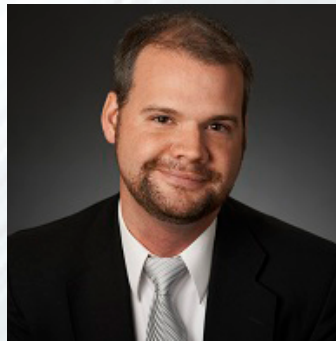


Occupational Fraud in Government: Stories from the Trenches

Presented By:



Brad Billet



Daniel Clark



Thomas Fryman



CLARK SCHAEFER HACKETT
CPAs & BUSINESS CONSULTANTS

Objectives

- Understand common fraud schemes and why they occur
- Improve your awareness of real-world frauds happening in governments
- Implement fraud prevention tools



Occupational Fraud:

A look at the numbers



2016 Report to the Nations

This report analyzes occupational fraud investigated between January 2014 and October 2015

- \$6.3 billion in reported losses
- \$150,000 median loss per case
- The typical organization loses 5% of revenues due to fraud

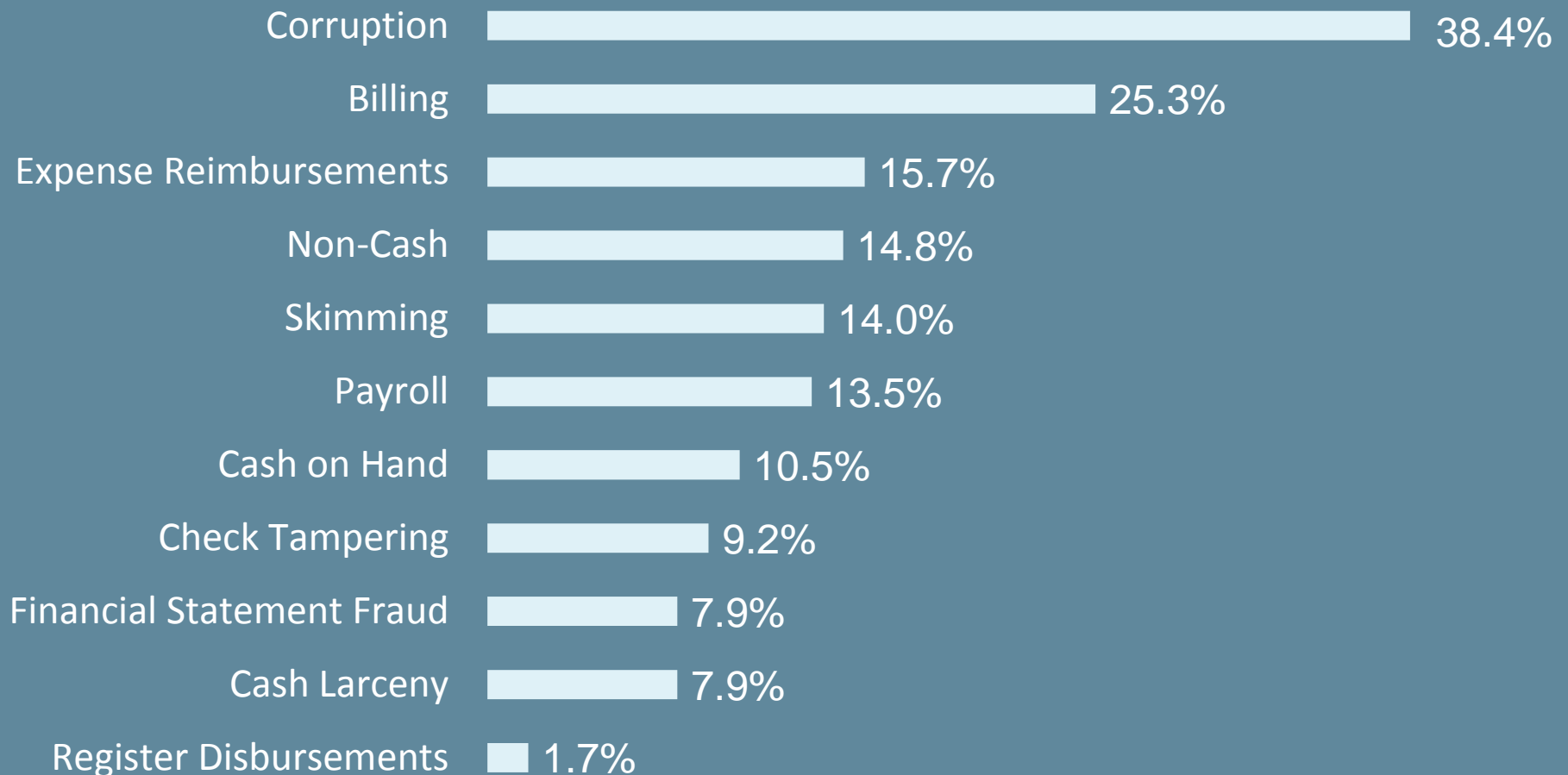


2016 Report to the Nations (cont.)

- Government and public administration organizations equaled 10.5% of total cases
- 2nd most of any industry
- \$133,000 = median loss

Level of Government	Percent of Government Organizations Reported	Median Loss
Local	32.3%	\$80,000
State/Provincial	31.3%	\$100,000
Federal	30.1%	\$194,000
Other	6.3%	\$62,000

Frequency of Schemes by Type

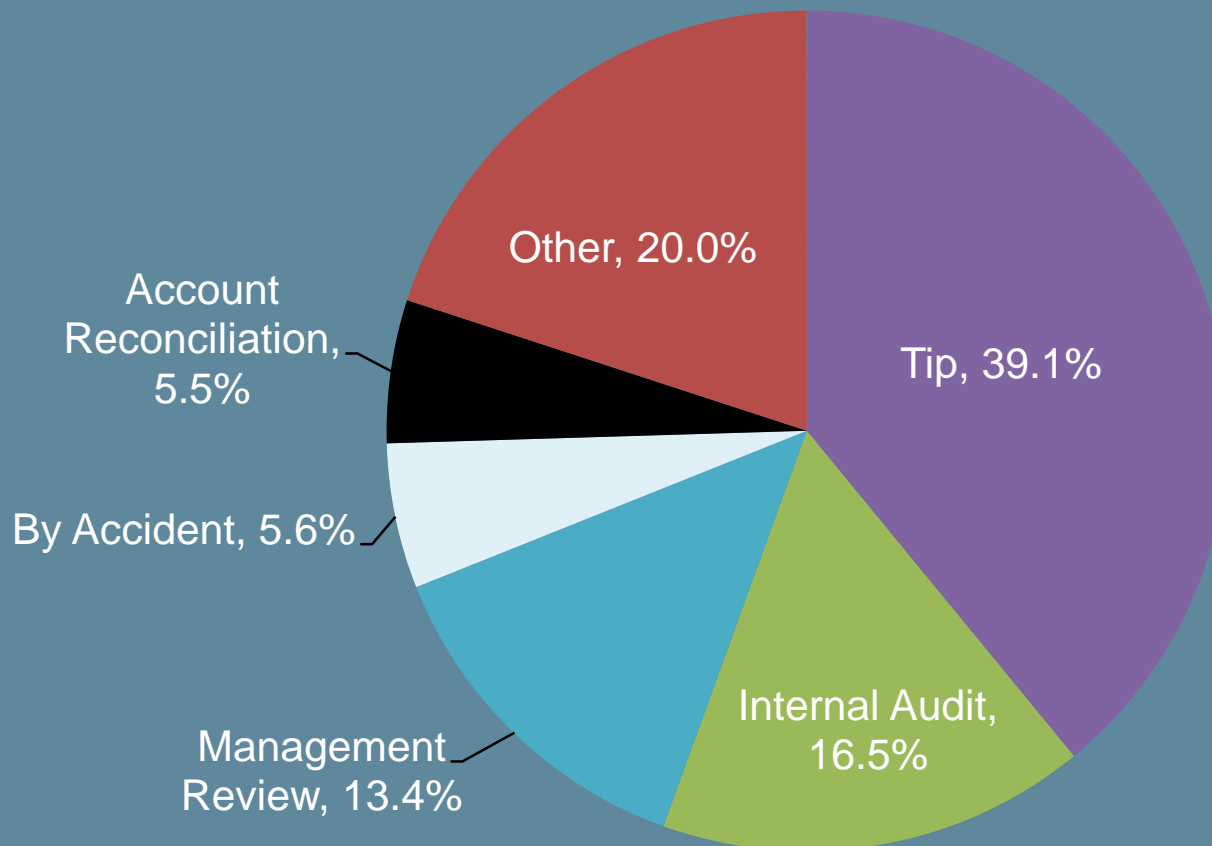


Frequency of Anti-fraud Controls



Initial Method of Detection

External Audit accounted for only 3.8% of initial detections



Common Fraud Schemes



The Rita Crundwell Case

- 63 years old
- Raised in Dixon, IL
- Treasurer/Comptroller of the City of Dixon, IL from 1983 to 2012
- City of Dixon 2012 annual budget = \$7m



The Scheme and Cover Up

- Crundwell opened a bank account titled Reserve Sewer Capital Development Account (RSCDA) with herself as the only signatory
- She moved City funds into a legitimate City account titled Capital Development Account (CDA)
- And created phony invoices that she paid with CDA checks payable to “Treasurer”

The Scheme and Cover Up (cont.)

- Crundwell deposited checks into RSCDA
- She blamed an economic downturn and late payments from the State for budget shortfalls
- She repeatedly argued for painful spending cuts at budget meetings to cover the deficit
- The City suffered as a result

Consequences to the City

- Police could not afford to upgrade squad car radios or make new hires
- Streets could not be resurfaced
- A waste water treatment facility had to be delayed
- The city was forced to issue \$3m in bonds to cover financial obligations



The Discovery

- Secret account discovered accidentally by a City employee
- Funds used to pay for a thoroughbred horse farm and lavish lifestyle:
 - Prize-winning horses
 - Expensive jewelry
 - Luxury cars
 - Extravagant parties

The Loss

- Crundwell embezzled approximately \$53m from the City from 1990 to 2012
 - 1991 = \$181,000
 - 2008 = \$5.8m
- The City of Dixon suffered significantly as budget shortfalls caused by Crundwell's deception impaired or halted important initiatives

The Loss – The Bottom Line

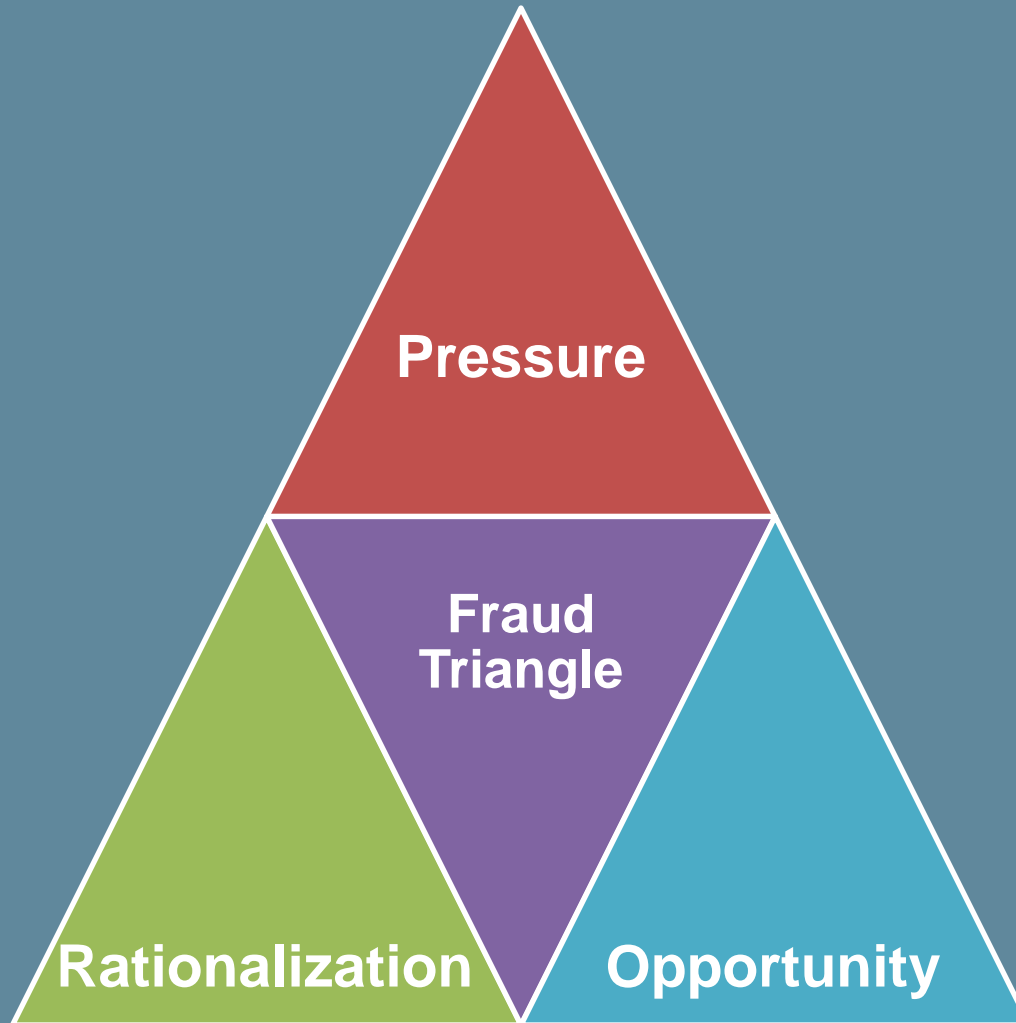
Amount misappropriated by Crundwell	\$54m
Attorney fees	<u>\$10m</u>
Loss to the City	\$64m
Recovery from sale of assets	\$10m
Settlement with accounting firm	\$35m
Settlement with audit firm	\$ 1m
Settlement with bank	<u>\$ 4m</u>
Dixon City's net loss	<u>\$14m</u>

Rita Crundwell: Plea and Sentencing

- Arrested April 17, 2012
- Pled guilty on November 14, 2012
- Sentenced to 19 years and 7 months in prison on February 14, 2013
- Largest municipal fraud in U.S. history



The Fraud Triangle



Preventing Rita Crundwell

- Enhanced segregation of duties including dual signatures
- Prohibit significant checks written to “Treasurer” or “cash”
- Rigorous budgeting with periodic budget-to-actual reviews
- Review of bank account statements and reconciliations by someone outside cash disbursement process
- Publish transparent and accessible financial records

The Bob Due Case

- 64 years old
- Finance Director for the City of Covington, KY (population = 41,000) for over a decade
- Annual general fund budget approximately \$48m in 2013



The Scheme and Cover Up

- Fictitious vendors & legitimate vendors were used to issue checks
- Due entered the office alone after hours to print the checks
- Just before printing, Due changed the name on the check making it payable to himself, an unwitting relative, or a vendor he controlled
- After printing the checks, he changed the name back to the vendor
- Phony invoices were created to support the fraudulent checks

The Scheme and Cover Up (cont.)

- Due had complete control over the City's financial activity
- No sufficient oversight or governance
- He had complete access to all accounting system functions
- He also acted as IT administrator, which allowed him to process payments using other employee accounts

The Discovery

- During a review of one of the fake vendors, the AP clerk discovered that the name field had been edited
- Due used funds for his own personal use, including deposits made to his retirement account

The Loss

- Due embezzled approximately \$793k from the City from 2001 to 2013
- Approximately \$5k to \$10k per month over the 12 years of misappropriation
- Settlement with insurance carrier, banks, CPA & other parties totaled \$272,500

The Loss (cont.)

- Due relinquished his pension money to the City, which totaled a minimum of \$330k
 - The City will receive \$22k per year during his expected life
 - And \$22k the 15 years following his death
- The City of Covington could receive an additional estimated \$338,800 depending on how long Due lives

Bob Due: Plea & Sentencing

- Charged August 23, 2013
- Pled not guilty & released on bond on August 24, 2013
- Pled guilty March 13, 2014
- Due was sentenced to 10 years in prison on June 5, 2014

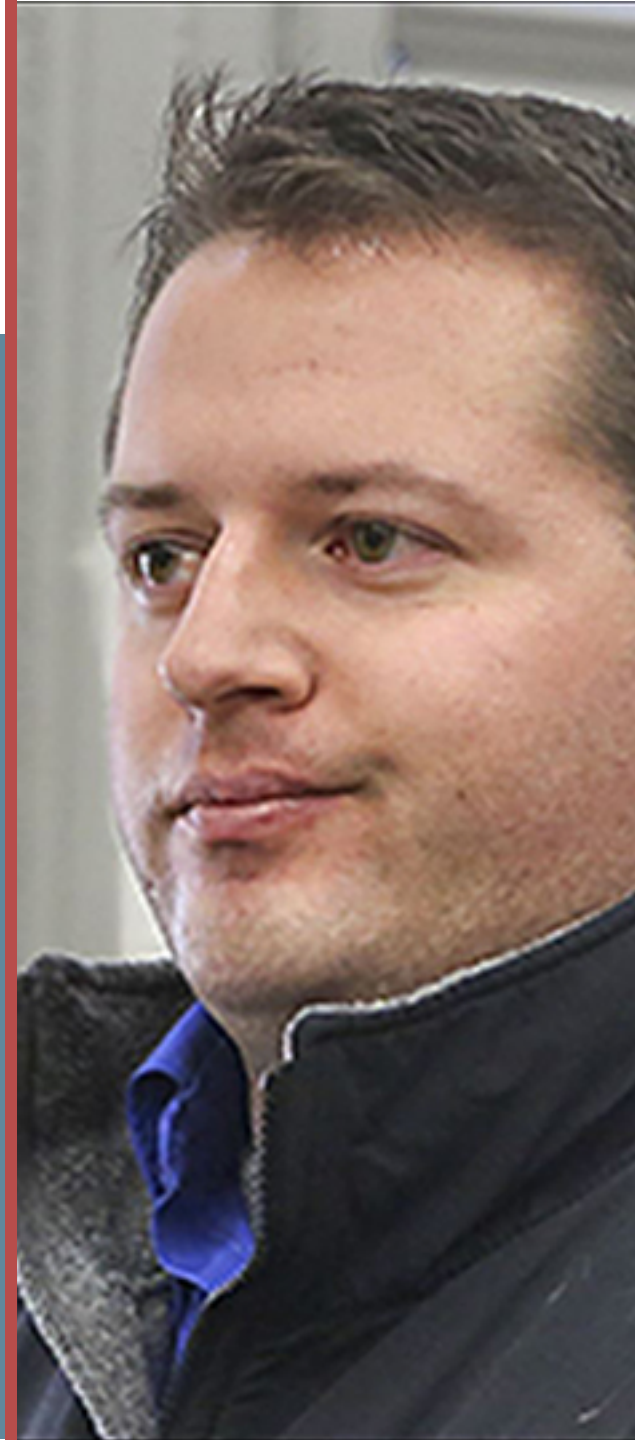


Preventing Bob Due

- Enhanced segregation of duties
 - Between IT and accounting
 - Within cash disbursement process
- Regular reviews of transaction change logs or audit trail reports
- Review and reconcile bank statements, including review and reconciliation of cancelled checks
- Review frequency of payments by vendor for unexpected trends

The Eric Whitson Case

- 31 years old
- Accounts Receivable clerk for the Perrysburg Exempted Village School District since 2004
- Worked for the school district for over 10 years



The Scheme and Cover Up

- Whitson transferred funds from the district account to both the Perrysburg Schools and Bowling Green Boosters accounts
- He replenished the money he took from the boosters' account with funds from the district
- Issued six district checks to the Bowling Green Boosters, where he volunteered as treasurer

The Scheme and Cover Up (cont.)

- Whitson used the booster accounts to issue himself six checks totaling \$19k
- He made 82 electronic payments totaling \$122k to his personal credit cards
- And issued seven unauthorized checks totaling \$18k to the district that were not for booster purposes

The Discovery

- A new volunteer treasurer with the boosters began questioning checks written from District schools (the boosters had NO interaction with Perrysburg Schools).
- \$169k in unauthorized checks that were used to cover up stolen cash of the same amount was discovered
- Discovered \$72k in unauthorized checks that were used to fund personal and corporate donations to the athletic department
- Whitson lived a lavish lifestyle:
 - Box tickets to sporting events
 - Weekend retreats for himself and friends
 - Gambling problem

The Loss

- Whitson embezzled approximately \$480k from the school district from 2009 to 2014
- Approximately \$182k from the Bowling Green Bobcat Athletic Boosters
- Findings for recovery totaling \$480k were issued against Whitson

The Loss (cont.)

- The District Treasurer was held jointly and severally liable for \$92k of this amount
- Whitson was ordered to pay nearly \$800k in restitution:
 - Forfeiture of \$36k from state retirement account
 - Payment of \$65k for a special audit conducted by the Ohio Auditor's office
 - Forfeiture of \$2k in cash, 4 computers and a smart phone seized from Whitson's home during a search

Eric Whitson: Plea & Sentencing

- His employment was terminated on July 14, 2015
- Pled guilty on December 14, 2015
- Whitson was sentenced to 10 years in prison on January 11, 2016



Preventing Eric Whitson

- Segregation of duties including dual authorizations and dual signatures
- Periodic review of cash disbursements summarized by payee or vendor
- Multi-level approval of purchase orders and/or check requests by supervisors and those outside of the department
- Conflict of interest policy and periodic conflict of interest reviews
- Rigorous budgeting process and budget-to-actual reviews for all accounts, including student activity funds
- Scrutinize checks made payable to credit card companies and review supporting documentation

Implementing Fraud Prevention Measures



Tip 1: Set a Positive Tone at the Top

- Involve your elected council or board, senior leadership and management at all levels
- Create a Culture of Accountability
- Establish a Code of Conduct
- Communicate Frequently
- *Regular dialog on fraud-related topics should be a routine part of your internal communications*

Tip 2: Implement Internal Controls

- Segregate duties: Basic building block of sustainable risk management and internal controls for an organization
- Monitor access: Ensure that duties are actually segregated as planned
- Management review:
 - Access and exception logs
 - Nonstandard journal entries
 - Details of reconciliations
 - Transaction records
 - Monthly financial information (budget vs. actual)

Tip 3: Hire, Train & Promote Ethical Employees

- Perform background checks
- Verify resumes and applications
- Train managers to conduct comprehensive interviews
- Develop a fraud prevention program



Tip 4: The Whistleblower Hotline

- #1 source of tips for fraud cases
- Hotlines work best when managed by an outside vendor
- Regularly promote the hotline as a reminder to would-be perpetrators
- Investigate & resolve each case consistently through a formal process to handle instances or suspicions of fraud

Tip 5: Identify & Measure Risks

- Dedicate a committee to complete fraud risk assessments (legal, HR, internal audit)
- Focus on identifying weaknesses and improving processes that prevent fraud
- Assess Incentive or Need:
 - Layoffs or downsizing?
 - A cut in salaries or fringe benefits?
 - Bonuses cut or eliminated?
 - Forcing employees to take a reduction in hours?

Tip 5: Identify & Measure Risks (cont.)

- Assess Rationalization:
 - How is morale and/or employee engagement?
 - Do employees feel they have been treated unfairly?
 - Is there a sense of resentment?
- Assess Ability or Access:
 - Internal controls and fraud prevention measures ensure fraud is detected quickly where incentive and rationalization are present
 - Weak controls mean employees can easily identify opportunities for fraud



Tip 6: Don't Rely on the Financial Audit

- Audits ARE NOT designed to detect fraud
- Nearly 80% of victim organizations had external audits
- However, external audits account for only 3% of fraud detection
- Twice as likely to find fraud by accident than as a result of your external audit

Tip 7: Engage an Expert

- CSH Consulting and Advisory Services
- Fraud Risk Assessment and Management Program
- Respond to detected fraud
- Attestation and financial consulting services

Questions?



Thomas Fryman,
Certified Fraud Examiner
937.226.0070
tfryman@cshco.com