Fraud: Like Other Stuff... It Happens

TCMA 2024 Spring Conference
“There is no kind of dishonesty into which otherwise good people more easily and more frequently fall than that of defrauding the government.”

- Ben Franklin
Objectives

• Review real-life fraud examples from Tennessee Comptroller’s Office investigation reports
• Discuss occupational fraud and the fraud triangle
• Discuss internal controls
• Review fraud statistics and common fraudster red flag behaviors
Case #1

**Background:**
- Population: 2,000
- 45 Employees
- Mayor and 5 Aldermen
- City Recorder responsible for all financial affairs
- Utilities – Water, Sewer, Natural Gas
RESUMEN DE INVESTIGACIÓN

1. EL REGISTRADOR DE LA CIUDAD NO PAGÓ A TIEMPO LAS CUENTAS DE VITALICIO Y INICIÓ TRANSACCIONES IMPROPIAS

2. [REDACTADO] USÓ LICENCIA ANUAL Y LICENCIA DE ENFERMEDAD CONDUCIENDO DUDOSO

3. [REDACTADO] PAGÓ A SÍ MISMO COMPENSACIÓN DUDOSA

En fecha 15 de septiembre de 2022, la Corte Mayor del Condado [REDACTADO] acusó a [REDACTADO] de un delito de Malversación y Malversación de Servicios Valuables por más de $1,000.

Las acusaciones y acusaciones contenidas en el escrito son acusaciones de delitos, y no prueba. El acusado está supuesto ser inocente a menos que se pruebe culpable más allá de toda duda razonable y condenado de acuerdo con el debido proceso de la ley.
Case #2

**Background:**
- Population: 4,000
- 62 Employees
- Mayor and 4 Aldermen
- Water, Sewer, Street
Case #2

RESULTS OF INVESTIGATION

1. EQUIPMENT OPERATOR [Redacted] PURCHASED GASOLINE TOTALING AT LEAST $811.23 FOR PERSONAL USE WITH A TOWN-OWNED FUEL CARD

3. CASH FROM THE SALE OF SCRAP METAL TOTALING AT LEAST $2,289.76 WAS NOT REMITTED TO THE TOWN RECORDER-TREASURER

On May 11, 2023, the [Redacted] County Grand Jury indicted [Redacted] for one count of Misdemeanor Theft of Property under $1,000.

The charges and allegations contained in the indictment are merely accusations of criminal conduct, and not evidence. The defendant is presumed innocent unless and until proven guilty beyond a reasonable doubt and convicted through due process of law.

[Redacted] Investigative Exhibit
Case #3

**Background:**
- Population: 300
- 9 Employees
- Mayor and 6 Aldermen
- Police Department
Case #3

RESULTS OF INVESTIGATION

1. FORMER POLICE CHIEF INITIATED QUESTIONABLE TRANSACTIONS FOR THE TOWN’S WEAPONS INVENTORY
Case #3

Exhibit 1

The two weapons the chief allowed former town police officers to keep following their resignation.
Case #3

The chief's town-issued weapons – CZ Scorpion and Kimber – that he purchased for $1.00
Case #3

Town-issued weapons – Springfield Armory 9mms and .45mm – that police officers purchased for $1.00
Case #4

Background:
• Population: < 500
• One part-time employee - City Recorder
• No City Hall until 2022
• City Recorder allowed to work remotely
Case #4

**Background:**

- 4 years behind on audits
- Auditor from the Comptroller’s Office attempted to set up multiple meetings with the city recorder
CASE #4

RESULTS OF INVESTIGATION

1. TOWN [REDACTED] CITY RECORDER [REDACTED] MISAPPROPRIATED TOWN FUNDS TOTALING $8,643

<table>
<thead>
<tr>
<th>Misappropriated Funds</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A) Extra Paychecks</td>
<td>$8,243</td>
</tr>
<tr>
<td>B) Verizon Payment</td>
<td>$400</td>
</tr>
<tr>
<td><strong>Amount of Misappropriation</strong></td>
<td><strong>$8,643</strong></td>
</tr>
</tbody>
</table>
Case #4

RESULTS OF INVESTIGATION

2. FALSIFIED THE MAYOR’S SIGNATURE ON CHECKS

On December 18, 2023, the County Grand Jury indicted on one count of Theft over $2,500 or more but less than $10,000 and one count of Forgery over $10,000 or more but less than $60,000.

The charges and allegations contained in the indictment are merely accusations of criminal conduct, and not evidence. The defendant is presumed innocent unless and until proven guilty beyond a reasonable doubt and convicted through due process of law.

Investigative Exhibit
Case #4

INTERNAL CONTROL AND COMPLIANCE DEFICIENCIES

Our investigation revealed deficiencies in internal controls and compliance, some of which enabled [redacted] to perpetuate [redacted] scheme without proper detection. These deficiencies included:

**Deficiency 1:** Town officials did not ensure collections were deposited promptly

**Deficiency 2:** Town officials did not provide adequate oversight and did not implement adequate segregation of financial duties

**Deficiency 3:** Town officials did not properly maintain board minutes

**Deficiency 4:** The recorder did not maintain all required records

**Deficiency 5:** Town officials circumvented internal controls by signing blank checks
Case #5

Background:

• Population: < 1,500
• Wastewater Treatment Plant
• Plant personnel perform sample tests and analyses on treated wastewater.
• Results are monitored to ensure pollutants are not being discharged into the water system.
Case #5

Background:

Former plant supervisor
Retired supervisor
Plant employee
Case #5

RESULTS OF INVESTIGATION

1. PLANT PERSONNEL PERFORMED WATER SAMPLE TESTING AND ANALYSES FOR THEIR PRIVATE BUSINESS WHILE USING CITY RESOURCES

A. Plant personnel were paid $10,847.52 by the city for the same work time they were working for their private business

B. The plant’s laboratory and equipment were used to perform testing for the private business resulting in a cost of $10,898.04 to the City

C. Plant personnel generated $277,875.00 for their private business while using city resources
RESULTS OF INVESTIGATION

2. PLANT PERSONNEL HAD QUESTIONABLE AMOUNTS OF ACCRUED COMPENSATORY TIME

A. Plant personnel accrued compensatory time while operating their private business

B. Questionable compensatory time totaling $15,328.69 was paid by the City to the former 2020 supervisor and employee
Case #5

INTERNAL CONTROL AND COMPLIANCE DEFICIENCIES

Our investigation revealed the following deficiencies in internal controls and compliance, some of which contributed to the City of [REDacted] Wastewater Treatment Plant personnel’s ability to perpetrate their misappropriation without prompt detection:

**Deficiency 1:** City officials did not provide adequate supervision and oversight of plant employees

**Deficiency 2:** Plant personnel exceeded the amount of accumulated employee compensatory time allowed by federal law

**Deficiency 3:** City management did not ensure compliance with the City [REDacted] personnel policies

**Deficiency 4:** Plant employees accrued incorrect and questionable amounts of compensatory time
Case #6

**Background:**
- Population: > 50,000
- City Garage
- Provides preventative maintenance and repair services to city fleet and equipment
- Responsible for conducting annual safety inspections on local taxicabs
Case #6

Background:
Administrative Support Technician responsibilities include:

• Managing p-card records
• Vehicle inventory process
• City-owned gas pumps
• Data input
• Purchase order requests
• Remitting money collected by garage personnel
Case #6

RESULTS OF INVESTIGATION

- CITY GARAGE ADMINISTRATIVE SUPPORT TECH
- MISAPPROPRIATED FUNDS TOTALING $1,653

Summary of Misappropriated Collections

<table>
<thead>
<tr>
<th>Collection Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Scrap Metal Sales 2020-2021</td>
<td>$1,053</td>
</tr>
<tr>
<td>B. Taxi Inspections 2019-2021</td>
<td>600</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,653</strong></td>
</tr>
</tbody>
</table>
Case #6

On April 4, 2022, the [redacted] County Grand Jury indicted [redacted] for one count of Theft over $1,000.

The charges and allegations contained in the indictment are merely accusations of criminal conduct, and not evidence. The defendant is presumed innocent unless and until proven guilty beyond a reasonable doubt and convicted through due process of law.

[City Garage Investigative Exhibit]
Case #6

INTERNAL CONTROL DEFICIENCIES

Our investigation revealed the following deficiencies in internal controls, some of which contributed to the Administrative Support Tech’s ability to perpetrate misappropriation without prompt detection:

**Deficiency 1:** City officials failed to provide appropriate oversight and did not separate incompatible financial duties

**Deficiency 2:** City officials did not ensure cash receipts were reconciled with deposits
Occupational Fraud

The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets.
Why are local governments vulnerable?

- Size of municipality
- Part-time employees
- Budget constraints
- Culture
- Lack of oversight
Why are local governments vulnerable?

• Denial – “Fraud won’t happen here”
• Poor internal controls
• Poor segregation of duties
• Overreliance on certain employees
• Lack of interfacing of IT across various departments
• Tone at the top
The Fraud Triangle

- Opportunity
- Pressure
- Rationalization
Internal Controls

TCA § 9-18-102

(a) Each agency of state government and institution of higher education along with each county, municipal, and metropolitan government shall establish and maintain internal controls...
# Internal Controls – Five Components

<table>
<thead>
<tr>
<th>Icon</th>
<th>Component</th>
</tr>
</thead>
<tbody>
<tr>
<td>🔄</td>
<td>Control Environment</td>
</tr>
<tr>
<td>⚠️</td>
<td>Risk Assessment</td>
</tr>
<tr>
<td>📐</td>
<td>Control Activities</td>
</tr>
<tr>
<td>💌</td>
<td>Information &amp; Communication</td>
</tr>
<tr>
<td>📈</td>
<td>Monitoring</td>
</tr>
</tbody>
</table>
Control Environment

• Integrity & ethical values
• Oversight responsibility
• Organizational structure
• Commitment to competence
• Accountability
Risk Assessment

What are our goals and objectives?

What could go wrong?

Where are we vulnerable?

How could someone steal in this department?

What is the process for collecting money?

What is the process for purchasing/paying bills?
Risk Assessment

1. Define goals & objectives
2. Identify possible risks
3. Assess likelihood & impact
4. Consequences
5. Risk response
Consider how fraud could occur
Identify possible fraud risks
Assess likelihood & impact
Consequences
Risk response
Risk Assessment Benefits

- Increases awareness of department objectives, risks, fraud risks, purpose of existing controls, etc.
- Analyze current controls to ensure they are sufficient.
- Review updates/changes to department - key personnel, processes, programs, budget, etc. on a periodic basis.
Control Activities

• Actions established by management through policies and procedures to achieve objectives and respond to risks
Types of Controls

Preventive
- Deter undesirable events
- Help prevent loss
- Emphasize quality
- Proactive

Detective
- Detect undesirable events
- Provide evidence of loss
- Do not prevent loss
- Provide evidence that preventive controls are functioning
Preventive Control Techniques

• Segregation of duties
• Proper authorization for transactions
• Adequate documentation
• Physical control over access
• No blank, signed forms
• Question unusual items
• Ongoing training
• Communicate internal control policies & procedures
Detective Control Techniques

• Reconciliations performed timely
• Reviews of performance – budget to actual comparison
• Physical inventories
• Review payroll payouts/reports
• Review adjustment reports
• Audits
Who is the Fraudster?
Level of Authority

Employee 37.5%
Manager 39.5%
Executive 23%
Where did they work?

- Operations: 15%
- Accounting: 12%
- Sales: 11%
- Upper Management: 11%
- Customer Service: 8%
- Purchasing: 7%
- Finance: 5%
How old is our fraudster?
Gender of the fraudster?

- Male: 75%
- Female: 25%
Fraudster info

• 84% displayed at least one behavioral red flag

• Only 5% had a prior fraud conviction
Our fraudster is...
Common Red Flags

• Living beyond means
• Doesn’t want to cross-train
• Family problems
• Behavior
• Addiction
• Refusal to take time off
• Relationship with vendors
Other Fraud Facts

• Once discovered, nearly half is never recovered
• External auditors rarely identify fraudulent activity
• Unmodified opinions on the financial statements do not mean that fraud is not occurring
• Fraud can easily occur and your books still be in balance
8 KEY WARNING SIGNS

75% of fraudsters displayed at least one of the **8 MOST COMMON** behavioral clues; each of these **BEHAVIORAL RED FLAGS** was observed in **AT LEAST 10%** of cases.

- 39% Living beyond means
- 27% Financial difficulties
- 20% Unusually close association with vendor/customer
- 13% Control issues, unwillingness to share duties
- 12% Irritability, suspiciousness, or defensiveness
- 12% “Wheeler-dealer” attitude
- 11% Bullying or intimidation
- 10% Divorce/family problems
FIG. 15  WHAT TYPES OF ORGANIZATIONS ARE VICTIMIZED BY OCCUPATIONAL FRAUD?

- Private company: $120,000, 25%, 44%
- Public company: $110,000, 25%
- Government: $138,000, 10%
- Nonprofit: $60,000, 9%
- Other: $218,000, 4%

Legend:
- Blue: Median loss
- Cyan: Percent of cases
Professional Skepticism

• An attitude that includes a questioning mind and a critical assessment
• Use when implementing and assessing internal controls
• “Trust, but verify.”
Suspicion of Fraud in Tennessee

- Municipal officials must report reasonable suspicion of fraud, waste, or abuse to the Comptroller’s Office within five working days.
- External auditors required to report fraud immediately.
- Failure to take action required by a position of authority is a lapse in professional integrity.
Contact Information

Eric Spencer
MTAS Finance & Accounting
Program Manager

Cassie Wheeler
MTAS Finance & Accounting
Consultant

eric.spencer@tennessee.edu
cassie.wheeler@tennessee.edu