

Fraud and Embezzlement: What you need to know

Presented by Patrick Priest, CIRSA's Assistant Director and Chief Financial Officer

The contents of this presentation reflect the view of the presenter, not of CML. 

Objectives

- To understand how fraud and embezzlement occurred at certain municipalities
- To identify the factors that allowed those employees and officials to violate their position of trust
- To learn how municipalities are detecting fraud and embezzlement
- To learn how victimized municipalities are recovering resources lost due to fraudulent activities.
- To learn how municipalities can prevent fraudulent activities by their employees and officials.

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Case Study: Dixon, Illinois



- City with 16,000 citizens
- Mayor and five Commissioners
- Small administrative staff
- Childhood home of Ronald Reagan
- Victim of largest municipal embezzlement in U.S. history

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Comptroller/Treasurer

- Began working in Dixon City Hall as work-study high school student.
- Appointed Comptroller and Treasurer in 1983.
- Sterling reputation
- Annual salary of \$80,000
- Extravagant lifestyle including a nationally renowned Quarter Horse breeding operation



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How did she get away with it?

- Fraud triangle is a three sided model for explaining the factors that cause someone to commit fraud.
 - Ability to rationalize behavior, pressure and opportunity.
- She was well known, highly regarded and trusted.
 - Local bank allowed her to open a City account.
 - Created fake invoices and diverted payments to secret account.
 - Her explanations of financial hardships were accepted without verification. Few saw any financial statements.
- She started small but had to slash budgets for City services to fund her embezzlement.
- She managed to steal \$5.8 million in 2008 alone.

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How was she caught?

- Over the years, total amount embezzled – **\$54 million**
- In later years, the amount embezzled equaled the entire revenues for the City.
- City Clerk served as Acting Comptroller while she was on an extended vacation.
 - Stumbled upon bank statements for her secret account.
- Mayor called the Federal Bureau of Investigations (FBI).
- FBI investigated for six months while she was still serving as Comptroller/Treasurer.
- She was met by the FBI when she arrived for work on April 17, 2012.

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Insurance Coverage



- Crime/employee dishonesty coverage may be included in your package policy.
- Stand alone Crime or Fidelity policy.
- Public Official Bond
- Pay attention to your limits and any exclusions.

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Preventing Fraud/Embezzlement

- Establishing a Comprehensive Framework for Internal Control will not only prevent fraud and embezzlement from occurring but also improve timeliness of detection.
- Committee of Sponsoring Organizations (COSO)
 - Internal Control – Integrated Framework
 - Fraud Risk Management Guide (with ACFE)
- The Government Finance Officer's Association (GFOA) recommends adoption of COSO's Framework as the basis of an internal control system and has published guidance on implementation by local governments.
- CIRSA added a new Loss Control Standard in 2014.

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Element 1: Control Environment

- COSO has identified five essential characteristics of a favorable control environment.
 - Commitment to integrity and ethical values
 - Independent oversight
 - Assignment of authority and responsibility
 - Competent Staff
 - Accountability
- From COSO/ACFE's Fraud Risk Management Guide
 - The organization establishes and communicates a Fraud Risk Management Program that demonstrates the expectations of the board of directors and senior management and their commitment to high integrity and ethical values regarding managing fraud risk.

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Element 5: Monitoring

- Effective monitoring has the following two characteristics:
 - Evaluations of internal control are performed.
 - The effectiveness of internal control is evaluated and communicated.
- From COSO's Fraud Risk Management Guide
 - The organization selects, develops and performs ongoing evaluations to ascertain whether each of the five principles of fraud risk management is present and functioning and communicates Fraud Risk Management Program deficiencies in a timely manner to parties responsible for taking corrective action, including senior management and the board of directors.

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For More Information

- Association of Certified Fraud Examiners (ACFE)
 - Report to the Nation
 - www.acfe.com
- Committee of Sponsoring Organizations (COSO)
 - Internal Control – Integrated Framework
 - Joint publication with ACFE: Fraud Risk Management Guide
 - www.coso.org
- Government Finance Officers Association (GFOA)
 - Best practice documents
 - Publication: An Elected Officials Guide to Internal Controls and Fraud Prevention
 - www.gfoa.org

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Questions?

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