How to Catch a Thief

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Background Ernie Cooper

❖ **FRAUD and ETHICS**: Last 30 + years: Interviewed and investigated many types of fraudsters, witnesses, victim organizations and people

❖ **PERPETRATORS**: CFOs, Chief Business Officers, Controllers, Business Managers, accountants, union employees, vendors, foreign subdivisions, financial institutions

❖ **Organizations suffering FRAUD**: School Districts (K-12), (High Schools), Universities, Community Colleges, Auxiliary Organizations, Municipalities, Special Districts, Not For Profits, Law Firms, Bar Associations, Family Owned Corporations, Small Businesses, Casinos, Commercial Businesses

❖ **Unique Perspective on Ethics and Fraud**
Vicenti, Lloyd & Stutzman, LLP
Business Advisors and CPAs

1. Audits
2. Tax
3. Consulting
4. Forensic Services Branch

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Contact me anytime
Topics to Cover

1. How does the FBI catch a thief
2. Types of fraud prevalent today
3. Reporting of fiscal improprieties
4. Current fraud claims
5. Key steps to prevent fraud
FBI Basic Investigative Techniques

1. Interview and Interrogation
2. Background Investigation
3. Physical Surveillance
4. “Wire Taps” aka Electronic Surveillance
5. Laboratory Analysis – “CSI”
6. Undercover Operations
7. Confidential Sources and Informants
8. Analysis of Financial Transactions

* Partially developed from the treatise prepared by Richard Nossen, entitled “The Seventh Investigative Technique” Nossen was formerly with the Criminal Investigative Division of the IRS
“Pasadena Residents Outraged over $6.4-Million Embezzlement Scandal”

Classic example of typical type fraud scheme and breakdown of controls

Former Pasadena employee Danny Wooten was arrested in December on suspicion of embezzling at least $5 million from Pasadena coffers over more than a decade (Los Angeles Times)

- I did not work on this specific case
- I have worked on numerous similar cases
Highlights of City of Pasadena Fraud

• **Source of Funds:** “Underground Utility Program”

• **Alleged Fraudster:** Danny Wooten, Program Manager for the UUP and city employee with Public Works-Engineering.

• **Period of fraud:** 8/2003 to 3/18/2014

• **Dollar amount of fraud:** $6,432,810.98

• **Fraudulent vendors:** 4

• **Referred to LADA’s Office**
Overview of Fraud Scheme

City of Pasadena
“Underground Utility Program”

- Collins Electric
  - $3,543,359
  - 163 invoices
  - 8/2003-12/2013

- New Covenant Center
  - $712,810.49
  - 33 invoices
  - 12/2009-7/2012

- SCEJ Center
  - $2,123,656
  - 98 invoices

- M. Jenkins
  - $43,985.49
  - 2 invoices
  - 6/2010
FOLLOW THE MONEY

City of Pasadena ➔ Collins Electric ➔ New Covenant Center ➔ Cashier’s Checks to D. Wooten

City of Pasadena

- SCEJ Center’s bank account
- New Covenant Center’s bank account
  (Bank accounts held in D. Wooten’s Name)
Internal Controls Breakdowns that Allowed the Fraud

1. Excessive responsibility, control, and authority given to an employee perceived as being a trusted employee.

2. Lack of written and documented policies and procedures

3. Approval for payments of invoices without a proper purchase order, contract, or agreement
Internal Controls Breakdowns that Allowed the Fraud

4. Acceptance of vendor invoices lacking sufficient information

5. Inadequate review and approval of invoice payment requests

6. Lack of segregation of duties in approving vendor invoices for payment, preparing invoice payment requests, and picking up check payments
Internal Controls Breakdowns that Allowed the Fraud

7. Lack of fraud/ethics training
8. Tone at the Top
9. Hotline
10. Background Checks
11. Failure of external audit?
State Controller said about the City of Bell……..

“Among the most glaring problems was the lack of internal controls. We found the City of Bell’s administrative and internal accounting control system to be, in effect, nonexistent, as all financial activities and transactions revolved around one individual – the former chief administrative officer – who apparently had complete control.”

State Controller John Chiang
True Real Life Cases

1. **Community College District – Dean, Vice President**
   - “Asleep at the Wheel” or
   - “We Made a Movie”

2. **Community College District – Fire Chief - Fire Academy**
   - “Ex Gets Even”

3. **Community College District – CBO**
   - “Surprise Lover in Mexico” or
   - “Secretary Knows All”

4. **K-12 Unified School District – Director of Facilities**
   - “Love my remodeled house – Thank you District” or
   - “Don’t mess with me - I will intimidate you”

5. **K-12 Unified School District – Director of Facilities**
   - “Dating the good-looking consultant while paying her extra benefits”
True Real Life Cases

   • “But my daughter can be a world-class dancer”

7. CSU AOA – Financial Supervisor, Recreation
   • “I love those refunds”

8. Community College District – Interim Accounting Manager
   • “Money orders and Vegas”

9. Beverly Hills Bar Association - CFO
   • “Pay or I Break Your Bones”

10. Real Estate Law Firm – Office Manager and Accountant
    • “How to become a Doctor with embezzled funds”

11. Casino – CFO and Vendor
    • “But I give to Charity”
How to Catch a Thief

Reporting of Fiscal Improprieties

Executive Order 813

Effective March 22, 2002
How to Catch a Thief

- Report to Chancellor’s Office within 24 hours (including auxiliary organizations)
  - Executive Vice Chancellor/Chief Financial Officer
  - The University Auditor at CO
  - Chair of the Trustees’ Committee on Audit
- [https://csyou.calstate.edu/Tools/Audit/Pages/Reporting-Improper-Activities.aspx](https://csyou.calstate.edu/Tools/Audit/Pages/Reporting-Improper-Activities.aspx)
How to Catch a Thief

- SAM Section 20080
- Report to 3 State Agencies
- DOF, OSAE & BSA
- All cases of actual or suspected
- Fraud, Defalcation or Other Irregularities
- Report to OSAE & BSA
- Actual or suspected thefts – state employees
How to Catch a Thief

- Report includes
  - Sequence of events
  - Internal controls that failed
  - Means of discovery
  - Corrective actions taken
  - Actual or estimated $$$
  - Punitive actions taken or being considered
How to Catch a Thief

- Report to DOF, OSAE & BSA
- Due the next business day
- Preliminary vs Complete Report
- Preliminary to Complete within 30 days
- Progress reports due every 30 days until Complete Report filed
Auxiliary Organizations Risk Management
Alliance: Crime Claims

1. Fraud in Connection with the Use of Federal Grant Monies

2. Auxiliary theft estimated to be $100K or about 500 textbooks

3. Fraudulent $94,000 check was cashed and cleared the bank. Bank alerted Auxiliary and Accounting Department discovered the loss

4. Change orders and bank deposits were recorded to the financial books, but not sent to the Bank--listed as Deposits in Transit on Bank Reconciliation
Auxiliary Organizations Risk Management Alliance: Crime Claims

5. Employee obtained cash register authorization code of former manager and used to void and cancel transactions to steal cash.

6. Physical inventory of the bookstore's textbook area discovered large quantities of books were missing.

7. Three of these missing book titles were all received on the same shipment from the same publisher and were checked in the same day.
Control Weaknesses That Contributed to Fraud

Figure 39: Primary Internal Control Weakness Observed by CFE

*“Other” category was not included in the 2010 Report*
Who Commits FRAUD?
Anybody is Capable of Committing FRAUD

Experience:  Last 30 + years: Interviewed and investigated many types of fraudsters, witnesses, informants, cooperating witnesses

Examples:

- Long time trusted employee
- Supply Clerk
- Cash Receipts Clerk
- Accounts Payable Clerk
- Controllers
- CFOs
- CPAs
- Purchasing Director
- Many Others
Perpetrators of Fraud

Perpetrator’s Gender, Age, Tenure, Education Level, Criminal History

ASSOCIATION OF CERTIFIED FRAUD EXAMINERS
“2014 REPORT TO THE NATION”
2. How is FRAUD Detected?
2014 Report to the Nations
How is Fraud Detected?

– Tips
– Account Reconciliation
– By accident
– Internal audit
– External audit
– Notified by police
– Management Review
– Confessions
2014 Report to the Nations
How is Fraud Detected?

- Tips – 42.2%
- Account Reconciliation – 6.6%
- By accident – 6.8%
- Internal audit – 14.1%
- External audit – 3.0%
- Notified by police – 2.2%
- Management Review – 16.0%
- Confessions – 0.8%
Some Key Steps in “How To Catch A Thief”

“Anti-FRAUD Program”
Fraud Prevention Checklist

The most cost-effective way to limit fraud losses is to prevent fraud from occurring. This checklist is designed to help organizations test the effectiveness of their fraud prevention measures.
Summary of Anti-FRAUD Program

1. POSITIVE TONE AT THE TOP
2. ESTABLISH INTERNAL CONTROLS
3. FRAUD AND ETHICS TRAINING
4. FRAUD REPORTING MECHANISM
5. PROACTIVE MEASURES – EMPLOYEE PERCEPTION
6. INTERNAL AUDIT
7. BACKGROUND POLICY
8. EMPLOYEE PROGRAMS
9. OVERSIGHT OF YOUR ANTI-FRAUD PROGRAM
Fraud Prevention Checklist

1. Is the **TONE AT THE TOP** a positive one of honesty and integrity?

- What is major responsibility and expectation of management/leadership?
- **Lead by Example** – “Walk the Talk”
- Remember basic **“core values”** – transparency – accountability - honesty
- **Talk** about importance of ethics
- Inform/educate all employees
- Keep your promises - integrity
Fraud Prevention Checklist

2. Are strong **INTERNAL CONTROLS** in place and operating effectively?
Common Internal Controls Weaknesses

✓ Lack of Segregation of Duties – No OVERSIGHT******
✓ Cash Receipts – Inadequate “Receipt System”, Delayed Deposits
✓ Inadequate “Budget” analysis
✓ Bank Reconciliations not prepared or incomplete
✓ Cancelled checks missing (or not reviewed by 3rd party)
✓ Employees with no vacations and very seldom out sick
✓ Unusual or confusing adjusted entries
✓ Original records not maintained, disorganized or missing
✓ Informal process for purchases – Conflict of Interest
✓ Lax policy for use of official Credit Card
✓ Computer, IT and Electronic Internal Controls
Fraud Prevention Checklist

3. Is ongoing **FRAUD** and **ETHICS TRAINING** provided to all employees of the organization?

- Do employees understand what constitutes fraud?
- Have the costs of fraud to the company and everyone in it — including lost profits, adverse publicity, job loss and decreased morale and productivity — been made clear to employees?
- Do employees know where to seek advice when faced with uncertain ethical decisions, and do they believe that they can speak freely?
- Has a policy of zero-tolerance for fraud been communicated to employees through words and actions?
Fraud Prevention Checklist

4. Is an effective **FRAUD REPORTING MECHANISM** in place?

- Have employees been taught how to communicate concerns about known or potential wrongdoing?

- Is there an anonymous reporting channel available to employees, such as a third-party hotline?

- Do employees trust that they can report suspicious activity anonymously and/or confidentially and without fear of reprisal?

- Has it been made clear to employees that reports of suspicious activity will be promptly and thoroughly evaluated?
Fraud Prevention Checklist

5. To increase employees’ PERCEPTION OF DETECTION, are the following proactive measures taken and publicized to employees?

- Is possible fraudulent conduct aggressively sought out, rather than dealt with passively?

- Does the organization send the message that it actively seeks out fraudulent conduct through fraud assessment questioning by auditors?

- Are “surprise audits” performed in addition to regularly scheduled audits?

- Is continuous auditing software used to detect fraud and, if so, has the use of such software been made known throughout the organization?
Fraud Prevention Checklist

6. Does the INTERNAL AUDIT DEPARTMENT, if one exists, have adequate resources and authority to operate effectively and without undue influence from senior management? Also conduct fraud risk assessments?
Fraud Prevention Checklist

7. Does the hiring policy BACKGROUND POLICY include the following (where permitted by law)?

- Past employment verification
- Criminal and civil background checks
- Credit checks
- Drug screening
- Education verification
- References check
Fraud Prevention Checklist

8. Are effective Human Resource and Management programs in place which (Pressure):

- Assist employees struggling with addictions, mental/emotional health, family or financial problems?

- Allow an open-door policy in place that allows employees to speak freely about pressures, providing management the opportunity to alleviate such pressures before they become acute?

- Consider having anonymous surveys conducted to assess employee morale?
9. Do you have an “Oversight Group” responsible for implementing your Anti-FRAUD Program?

- Consider forming: “Anti-FRAUD” Group
  - Select Chairperson to “Shepherd” the Group

- Each department should have input
  - Treasurer and Finance Officers
  - Human Resource
  - General Counsel
  - Security, IT, Investigative, Compliance
  - Audit Committee, Internal Audit
How to Catch a Thief

Questions & Comments