



# Avoid Headlines/ Sleep Peacefully

BEST PRACTICES ON HOW  
TO MITIGATE MUNICIPAL  
EMPLOYEE FRAUD

California Municipal Treasurers  
Association - 2016 Annual Conference

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## BEST PRACTICES ON HOW TO MITIGATE MUNICIPAL EMPLOYEE FRAUD

Deceitful employee misconduct damages reputations, reduces resources available to provide services, and hurts esprit de corps. During this presentation MGO will share its experience with an “alleged” \$6 million fraud, providing a roadmap on how to respond to and prevent employee fraud. Transparency, accessibility, and responsiveness are hallmarks of Pasadena’s response. The City’s response includes a city-wide fraud risk assessment to identify employee misconduct risks for corruption and the wrongful taking or use of City assets with prevention and timely detection as key objectives. Don’t miss this presentation – you will sleep more peacefully with the insights and tools you will acquire.

# Presenters



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# Recent Government Fraud Cases

- **2015 Association of Bay Area Governments, CA \$1.3M**
  - One time wire transfer of Community Impact Fees
  - Financial Services Director
- **2014 City of Pasadena, CA \$6.4M**
  - 11 years alleged phony invoices to Underground Utility Program
  - Public Works Management Analyst
- **2014 St. Louis County, MO \$3.4M**
  - 6 years overcharged IT computers & technical services (conflict of interest)
  - Agency Division Manager
- **2012 City of Dixon, IL \$54M**
  - 22 years phony invoices
  - City's Treasurer

## How Can It Happen?

- Segregation of duties
- Management review
- Undocumented procedures
- Exception processing
- Trust without verification and validation
- Accountability design

# What Happens After it's Discovered?



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## FALLOUT

- Press
- People
- Morale
- Focus

## RESPONSE

- Investigations
- Task Force
- Policy and Procedure Review
- Internal Control
- Training
- Fraud Risk Assessment
- ERP



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# Working Definitions

## Fraud:

Employee misconduct that uses deceit to take or misuse an employer's assets or authority for the employee's benefit.

## Risk Assessment:

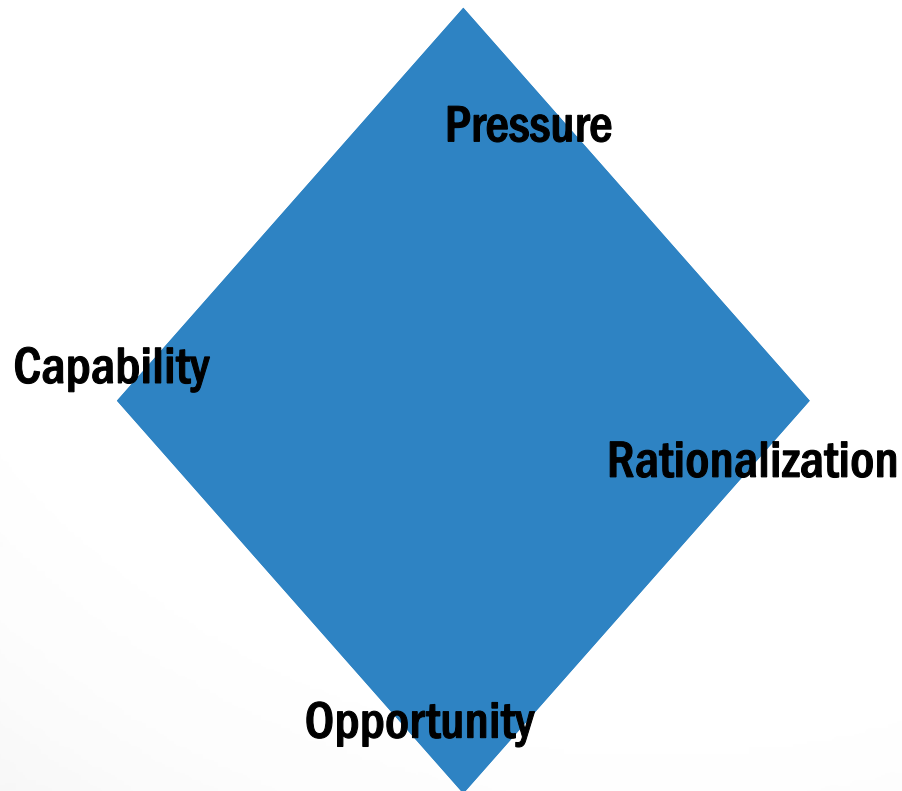
Identification of events that could prevent, delay, or increase costs of achieving organizational objectives.

DAVID WOLFE AND DANA HERMANSON

# Fraud Diamond



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- Pressure
- Rationalization
- Opportunity
- Capability



# Fraud Tree Branches

- Corruption
- Asset Misappropriation
  - Cash
  - Non-Cash
- Financial Reporting

# Risk Assessment



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## ENTERPRISE RISK MANAGEMENT (COSO 2004)

- Internal Environment
- *Objective Setting*
- *Event Identification*
- Risk Assessment
- *Risk Response*
- Control Activities
- Information & Communication
- Monitoring

## INTERNAL CONTROL-INTEGRATED FRAMEWORK (COSO 2013)

- Internal Environment
- Risk Assessment
- Control Activities
- Information & Communication
- Monitoring

# Risk Assessment

## ENTITY OBJECTIVE CATEGORIES

- Strategic
- Operations: efficiency, effectiveness, **safeguarding**
- Compliance
- Reporting: financial and non-financial



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# Fraud Risk Assessment

- Understand the organization/business unit
- Understand the resource flows
- Identify the probable fraud schemes for the resource flow
- Understand the internal environment and processes
- Interviews, observations, and reviews

# Prevention & Detection

## PREVENTION

- Written fraud policy
- Orientation, onboarding & training
- Critical management reviews
- Whistleblower channels
- Communication
- 3 Lines of defense

## DETECTION

- Tip (37%)
- Management review (14%)
- Internal audit (14%)
- Good luck (accidental) (7%)
- Account reconciliation (6%)



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# Notable Fraud Cases

- **2003 ING Reinsurance Division, MN \$8.5M**
  - ERP implementation segregation of duties
  - Accounting Manager
- **2014 St. Louis County, MO \$3.4M**
  - 6 years overcharged IT computers & technical services (conflict of interest)
  - Agency Division Manager
- **2012 City of Dixon, IL \$54M**
  - 22 years phony invoices
  - City's Treasurer
- **2014 City of Pasadena, CA \$6.4M**
  - 11 years alleged phony invoices to Underground Utility Program
  - Public Works Management Analyst

# Questions? Let's Talk.

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#### CMTA Disclaimer

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