

# *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:** CFO's, 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, Community Colleges, Casinos, Commercial Businesses
- ❖ **Unique Perspective on Ethics and Fraud**



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# Topics to Cover

1. How Does the FBI Catch A Thief
2. Types of fraud prevalent today
3. Facts of Fraud and Steps to Prevent Fraud
4. Assessing Internal Controls by a District
5. Working with the External Auditor



# 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



# RECENT CASE EXAMPLE CITY OF PASADENA

- I did not work on this specific case
- I have worked on numerous cases very similar
- **Classic example of typical type fraud scheme and breakdown of controls**



# “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)



Pasadena City Hall (Gina Ferazi/Los Angeles Times)

- ❖ I did not work on this specific case
- ❖ I have worked on numerous similar cases



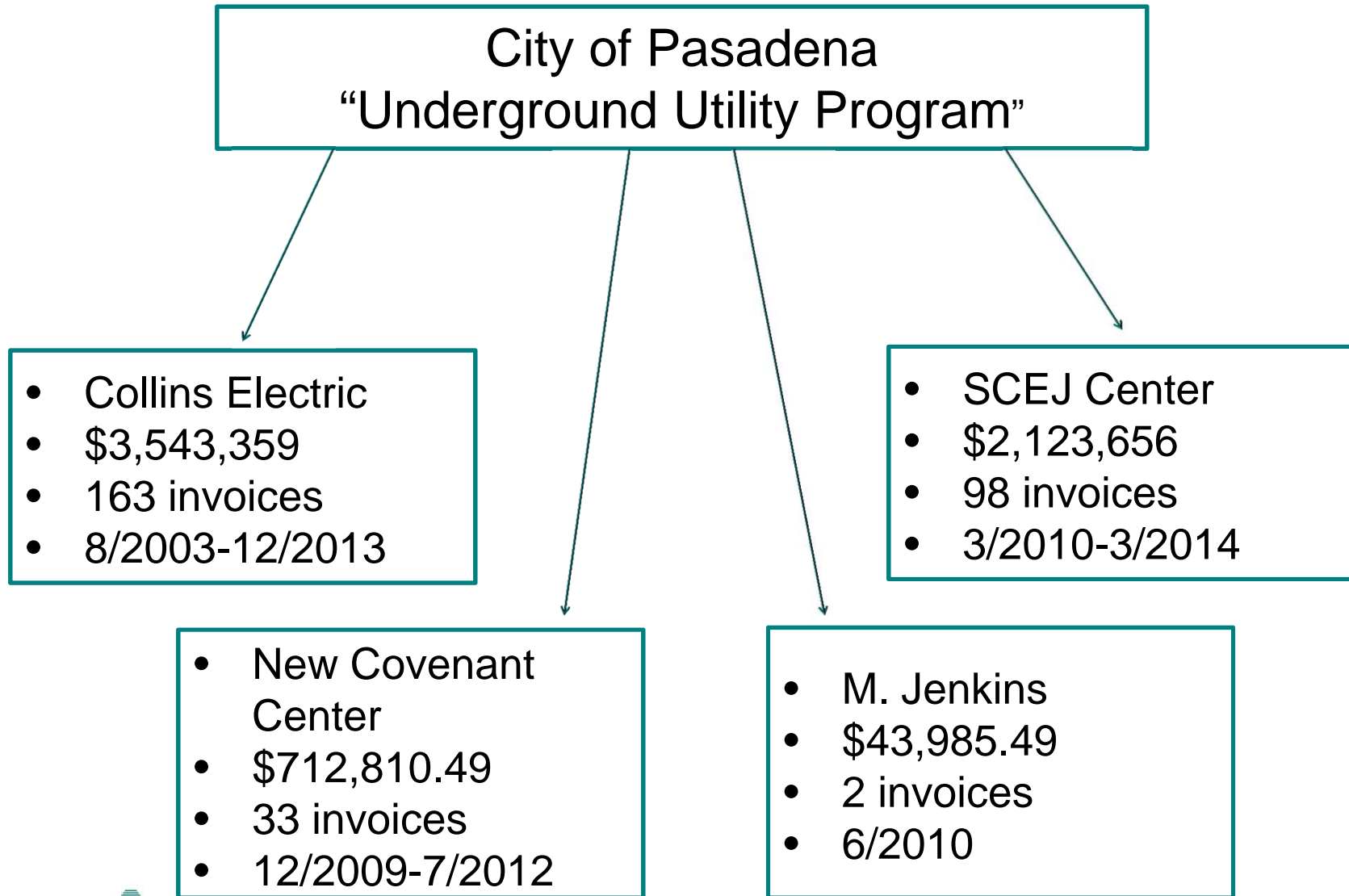


# Highlights of City of Pasadena Fraud

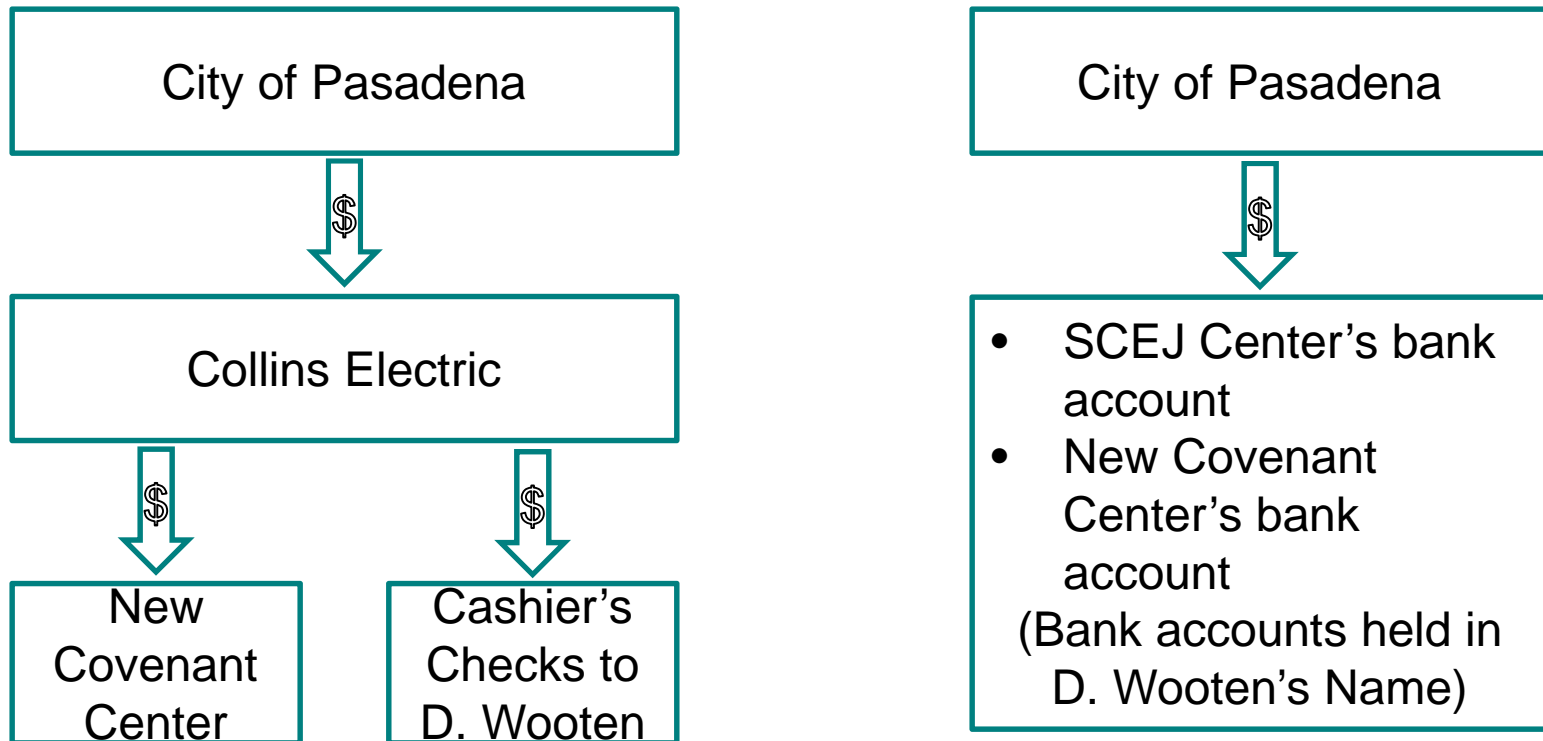
- **Source of Funds:** “Underground Utility Program”
- **Alleged Fraudster:** Danny Wooten, Program Manager for the UUP and city employee with Public Works-Engineering.
- **Period of fraud:** 8/2003 to 3/18/2014
- **Dollar amount of fraud:** \$6,432,810.98
- **Fraudulent vendors:** 4
- Referred to LADA’s Office



# Overview of Fraud Scheme



# FOLLOW THE MONEY



# 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.....

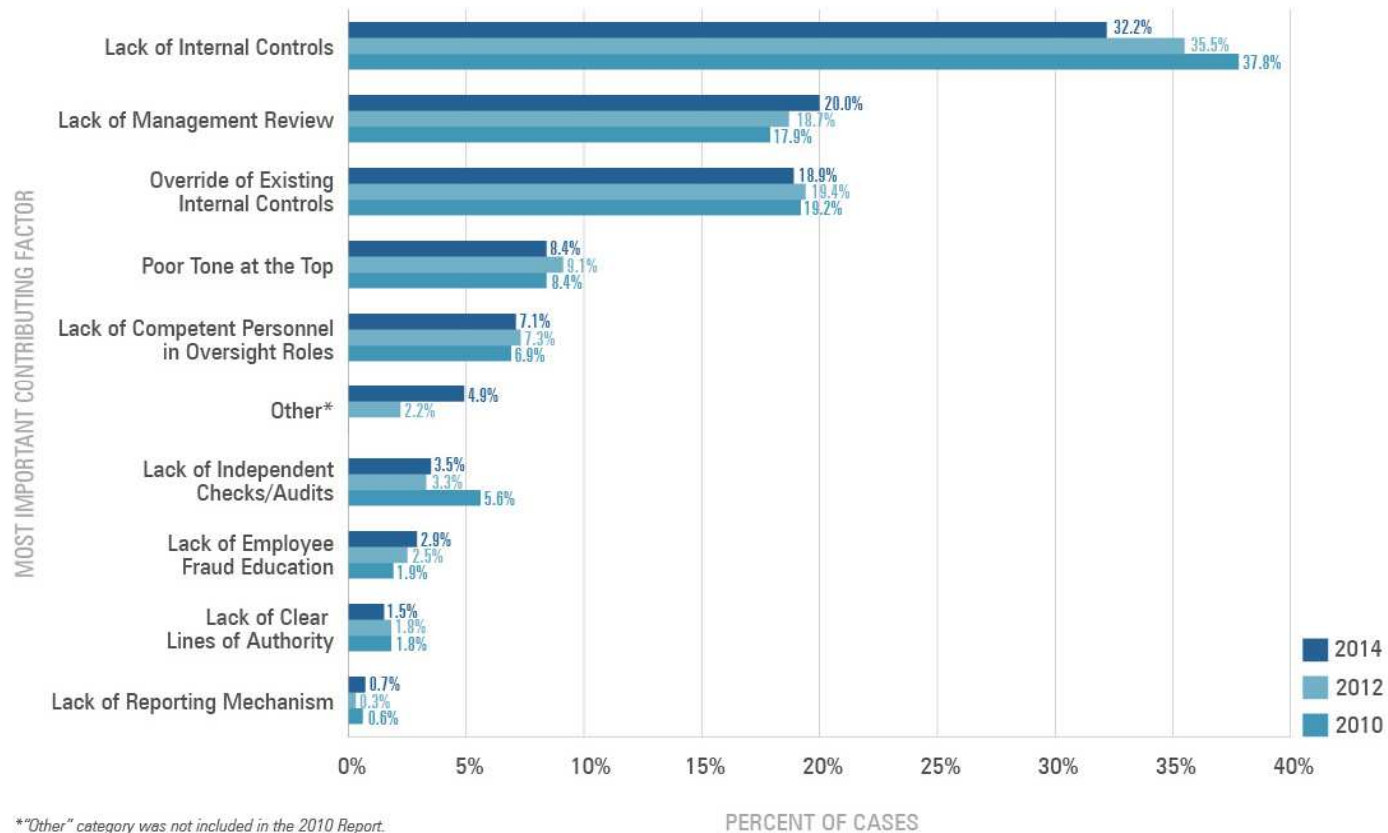
“Among the most glaring problems was the **lack of internal controls**. We found the City of Bell’s administrative and internal accounting control system to be, in effect, nonexistent, as all financial activities and transactions revolved around one individual – the former chief administrative officer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

**State Controller John Chiang**



# Control Weaknesses That Contributed to Fraud

**Figure 39: Primary Internal Control Weakness Observed by CFE**



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# Fraud and Abuse

# What is FRAUD?

Obtaining money or property by means of false or fraudulent pretenses

Intentionally taking something that doesn't belong to you

**Fraud is intentionally stealing, cheating or lying to obtain something that doesn't belong to you**

Occupational Fraud: "Use of one's occupation for personal enrichment through the deliberate misuse or misapplication of your employers resources or assets"

Is it **Error, Abuse or Fraud?**

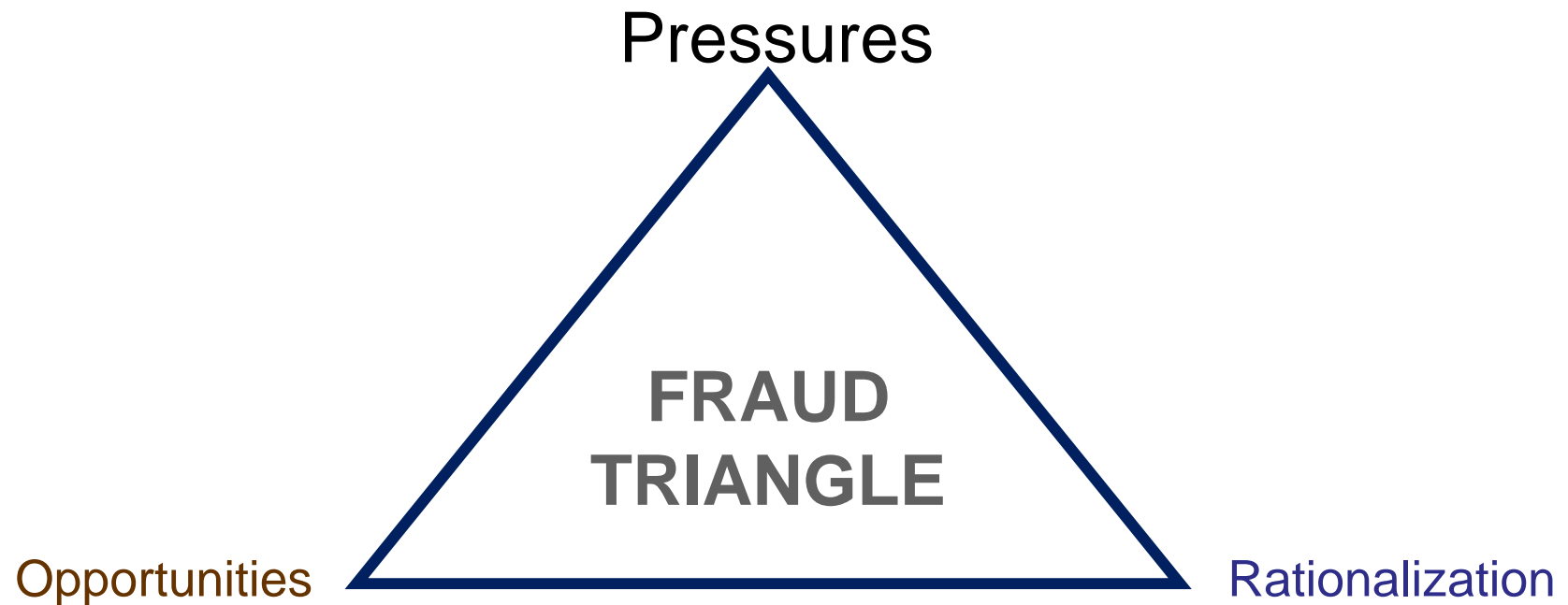


# Why is FRAUD Committed?

## Fraud and the Three Factors of “The Fraud Triangle”



# What 3 Factors are Usually Present in a Fraud?



# Understanding Why FRAUD is Committed...

Is important because helps you understand how important strong internal controls can:

**“Minimize the Risk of ABUSE and FRAUD”**



# Pressures

**“Serious financial problem that requires immediate attention and cannot be resolved by ordinary financial resources”**

- Gambling, drinking, other addictions
- Personal financial problems: divorce, medical, living above means, unemployed, girl(boy)friend, “second family”, unforeseen life change
- Maintain current lifestyle which is above your income
- Pressures on organization to meet financial expectations
- Significant threats to personal wealth
- Maintain financial solvency, debt ratios



# Opportunity

**“Become aware that financial problem can be solved by stealing from organization or falsifying organizations records”**

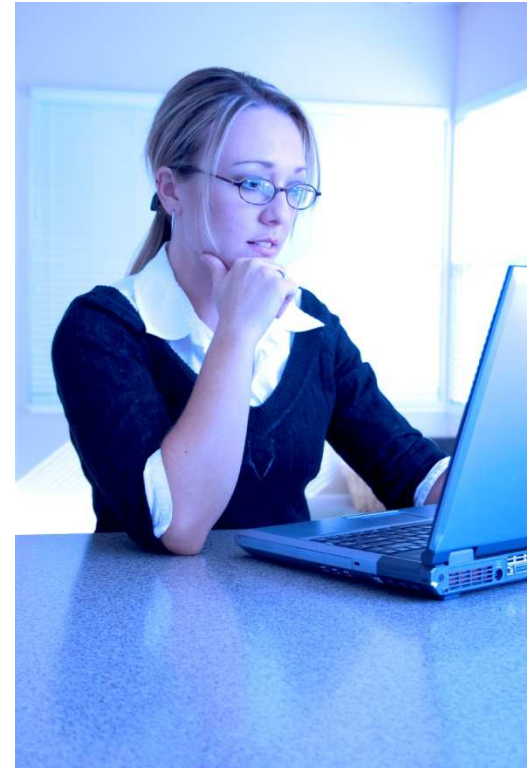
- **Weaknesses in internal control to guard assets**
- Lack of documentation
- Slacking on documentation
- Lack of supervision
- Inadequate segregation of duties
- Lack of background checks
- Management override of internal controls
- Certain type of transactions – personal purchases – easy to do



# Rationalization

**“Mindset and thinking that what you are doing is justified”**

- It is just temporary, and will I will pay back
- Management does not care
- No one else is hurt
- I deserve it
- Small amounts and they will not be missed





# Video

## “FRAUD REAL LIFE CASE”



# 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"**



# How is FRAUD Detected?



# 2014 Report to the Nation

## How is Fraud Detected?

- Tips
- Account Reconciliation
- By accident
- Internal audit
- External audit
- Notified by police
- Management Review
- Confessions



# 2014 Report to the Nation

## 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%



# Current Trends of Fraud



# Georgia Tech Employee Arrested Fraudulent Use of P Card

- Attorney General Baker indicted Michelle Harris in March 2008 after state auditors discovered **Harris had used her state-issued purchasing card (P-card) to make numerous personal purchases.**
- Michelle Harris was employed **as a program coordinator by Georgia Tech's College of Management.** Ms. Harris was issued a purchasing card for use in her official duties. **From June 2003 until May 2007, however, Ms. Harris illegally used her purchasing card to make personal purchases.** The personal charges on Ms. Harris' state issued credit card included car insurance, cellular telephone bills, personal tuition at Georgia State University, college tuition for a member of her family, car repair, tens of thousands of dollars in Sam's Club gift cards, a diamond ring, and over \$4,000 in catering for a wedding reception.
- The **fraud was initially discovered during a State Department of Audits review of purchasing card activity,** and the case was investigated through the joint efforts of the Audit Department, the National Science Foundation Office of Inspector General, the Georgia Bureau of Investigation, and the Department of Internal Auditing at Georgia Tech.



# 2 UGA employees charged with Purchasing Card Fraud

- Laura Cobb Watson, 47, of Statham, was booked into the Clarke County Jail on Wednesday on charges of **using state resources for personal gain**, theft by conversion, and altering public documents.
- Watson was a **senior accountant** for the College of Education's Educational Psychology and Instructional Technology Department
- Kathy Ingram Knudson, 51, of Watkinsville, is an **administrative assistant** in the same college department. She surrendered at the jail, where she was booked in on one count of use of state resources for personal gain.
- "A private vendor from the Athens area noticed a transaction using a UGA purchasing card and felt it was suspicious and reported," Dellinger said, "Our investigation revealed they used **state p-cards for the purchase of property for personal gain.**"



# Two former employees of the San Mateo County Community College District arrested on suspicion of embezzling more than \$100,000 in public money

- Bradley Witham and Mark Boustos were recently fired after being charged with numerous felony counts over a pattern of **improper spending with a college district credit card**, according to the San Mateo County District Attorney's Office.
- Witham was the **former head of information technology for the district**.
- "One of the individuals was using a procurement card that belonged to the district, making transactions online, **purchasing numerous electronic items, and then selling them on websites like eBay and Craigslist and making a profit**," said deputy district attorney Karen Guidotti.
- After the unusual spending was discovered, investigators sought search warrants to review records from eBay and Craigslist to document what became of the suspect purchases. Guidotti said **Boustos helped Witham cover up the alleged embezzlement**.



# Mt. SAC Fire Chief Sentenced to 5 years in jail

- **Former director of the Mt. San Antonio College Fire Technology Program** was sentenced Tuesday to five years in jail and ordered to repay the school nearly \$443,000 in embezzled school funds.
- Austin - who was the program's director from 2003 to 2010 - was arrested in January 2011 after school officials **discovered a fraudulent off-the-books bank account that he opened in the college's name.**
- Austin, at the hearing said he was simply thinking "**outside of the box**" when he created the bank account to help fund the cash-strapped program and keep it up to par with other academies. He said the additional funding was needed to pay for equipment and supplies.
- **"I am a good person, always have been,"** he said. "There was not one student that lost anything. Out of the 600 students that I graduated, not one student complained. Eighty percent of those students are firefighters today because of what we accomplished." Still, Judge George Genesta said Austin operated on a "foundation of fraud and deceit."



# Ex-Police Officer pleads no contest to embezzling

- **Former Arcadia police officer** pleaded no contest to stealing nearly \$42,000 from a police association while serving as treasurer
- Used money to buy such items as cigars and motorcycle parts
- Used the group's credit cards **to buy personal items – paid credit cards with organization's checking account**
- Reported by LA Times – July 19, 2014





RIVERSIDE – (INT) – Two men are facing up to 4-years in prison for **defrauding the Pechanga Tribe of Temecula out of more than \$4 million.**

A Superior Court jury Monday found James Riley and Ryan Robinson guilty of three counts each of commercial bribery.

Riley served as a broker for a majority of the insurance for the tribe.

**Robinson was the former chief financial officer for the Pechanga Resort and Casino and Tribal Government Center.**

The pair was indicted by the Riverside County Grand Jury in 2010. They'll be sentenced July 3rd.

Story Date: May 1, 2013

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### PECHANGA: Men begin serving bribery sentences



James William Riley

RIVERSIDE COUNTY SHERIFF'S DEPT./COMMUNITY SERVICE

1 of 2

187 0 0

Text Size

BY SARAH GURSIG | STAFF WRITER | July 11, 2013, 8:16 PM | Comments (0)

A former insurance broker and a longtime official of the Pechanga Resort & Casino near Temecula, who were accused of bilking the tribe out of millions, surrendered Wednesday, July 17, to begin serving their sentences for commercial bribery convictions.

James William Riley, 46, of Murietta, and Ryan Jay Robinson, 42, of Temecula, the casino's former chief financial officer, were convicted April 29 after their second trial. They were

http://www.pe.com/local-news/riverside-county/temecula/temecula-headlines-index/20130717-pechanga-... 7/24/2013

Today's Poll

How do you feel about beer?

- They treat me out. Maybe I've seen too many vintage trucks.
- They are fascinating, and generally fearless, and/or...
- Like any wild animal. I'm/tae, use fire if left alone.
- I have no opinion.

2,088

Video Search

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- POLITICAL (SERIES):** A cover story on...  
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- PE NAKES UP CALL:** How does peering...  
Published Wednesday, July 24, 2013  
Category: News & Politics
- Temecula Library Journeys:** This local...  
Published Tuesday, July 23, 2013  
Category: Events
- REUNITE:** Neighbor of another found...  
Published Tuesday, July 23, 2013  
Category: News & Politics
- HOUSE TODAY:** Will all members...  
Published Tuesday, July 23, 2013  
Category: Entertainment

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**SONS RESPONDING:** Two...  
teams sought in 50-year-old...  
receptionist's attack.

**TOBACCO:**...  
are searching for an "Obama-...  
for the purpose of "helping" another?

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# **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 3<sup>rd</sup> 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 (Pressures):
- Assist employees struggling with addictions, mental/emotional health, family or financial problems?
  - Allows 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?



# Fraud Prevention Checklist

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**



# Assessing Internal Controls by a District and Working with the External Auditor

- **Develop Procedures for:**
  - **Cash handling**
  - **Bank transactions/reconciliations**
  - **Check printing processes**
- **Cross-train personnel/periodically rotate job assignments**
- **Automated Systems**
- **Review/check each other's work (checks and balances)**
- **Periodic internal audits**
- **Work with External Auditors if any concerns**
- **Trust your findings/observations/instinct**



# Questions & Comments

