When Helping Hands “Help” Themselves

Guler Wiefling, Partner - Forensics and Litigation
Stephen Howard, Director - Forensics and Litigation
Katherine McMillen, Senior Associate - Forensics and Litigation
I. Fraud, Waste and Abuse in Public Sector
   - Today’s culture and environment
   - When the good guys go bad

II. Professional Skepticism

III. Principles of Conducting an Investigation
### Definitions

#### FRAUD, WASTE AND ABUSE

<table>
<thead>
<tr>
<th><strong>Fraud</strong></th>
<th><strong>Waste</strong></th>
<th><strong>Abuse</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>A type of illegal act involving the obtaining of something of value through willful misrepresentation. Fraud is any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain.</td>
<td>Involves the taxpayers not receiving reasonable value for money in connection with any government funded activities due to inappropriate acts or omission by players with control over or access to government resources. Waste goes beyond fraud and abuse and most waste does not involve a violation of law, primary to mismanagement, inappropriate actions and inadequate oversight.</td>
<td>Involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interest or those of an immediate or close family member or business associate.</td>
</tr>
</tbody>
</table>
For years politicians have been promising to win the war on fraud, waste, and abuse.

- In 1982, Ronald Regan asked investigators to “work like tireless bloodhounds...to root out inefficiency”, calling fraud, waste, and abuse “the byproduct of mismanagement.”

- In 2012, President Obama spearheaded a “campaign to cut waste” that would “hunt down and eliminate misspent tax dollars in every agency.” The goal was to restore citizen trust in government.

- In 2015, The Government Accountability Office announced it found $137 billion in improper payments, an increase of $31 billion from the prior two years.
Fraud and corruption in the public sector
- Severely harm the economy
- Lower investment levels
- Reduce public finances

Damages done to public institutions and their budgets by fraud and corruption can be enormous, ranging from financial loss to reduction of organizational performance, reputation, credibility and public confidence.
When the Good Guys go Bad

Common factors to identify for potential areas of fraud, waste, and abuse:

- Lack of internal controls and proper segregation of duties
- Autocratic management style
- Management override of controls
- Positions with high rate of turnover
- Individuals that have held the same position for an extended period of time
- Individuals that seem to have a sense of entitlement
Salvador Galván, 47, of La Mirada, the former deputy treasurer for the City of Compton, pleaded guilty yesterday to federal charges stemming from his theft of more than $3.7 million of city funds.

Galvan, who worked in the Compton Treasurer’s Office for more than 20 years, was responsible for tallying the cash received by the city as payment for parking tickets, business licenses and other fees. After the cash was counted, Galvan prepared the money for deposit into a city bank account. According to court documents, Galvan skimmed cash from the daily receipts on numerous occasions, sometimes taking as much $8,000 per day.

Mr. Galvan pleaded guilty to one count of theft from an organization receiving federal funds, a felony offense that carries a statutory maximum sentence of 10 years in federal prison. His wife was also charged with money laundering related to the embezzled funds and will be sentenced later this year.
Former City Treasurer Found Guilty of Falsifying Invoices to Steal Over $54 Million in Public Funds

- Former Treasurer, Rita Crundwell, for the City of Dixon, was able to steal nearly $54 million in city funds for more than 22 years after a local bank allowed her to open a secret account in the city's name without proper documentation.

- Crundwell, 60, who used the money to fund a lavish lifestyle and a horse-breeding operation, was sentenced to nearly 20 years in prison after pleading guilty to a single count of wire fraud and admitting to money laundering.

- The longtime city treasurer hid massive thefts by creating 180 fictitious invoices for made-up capital projects, but auditors never took any of the standard steps to try to verify the work and didn't raise questions about problems with the paperwork. The auditors, though, failed to notice that Crundwell's phony invoices contained misspellings and were not on state letterhead.

- For at least two decades, the same auditors reviewing Dixon's finances were also preparing Crundwell's personal tax returns, but they failed to be alarmed by the hundreds of thousands of dollars she claimed in income a year on her returns even though she had no documentation.
When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management oversight of controls, and recognizing the fact that audit procedures that are effective for detecting error may not be effective in deterring fraud.

PCAOB AU Section 110
Professional Skepticism

Key Elements

Attributes

Knowledge
Skill
Ability

Objectivity

Mindset

Good faith
Integrity
Assume neither honesty nor dishonesty
Recognize possibility of fraud

Action

Diligently gather and evaluate evidence
Assess the risk
Assign and supervise
Awareness

WHODUNNIT?
Did you notice the 21 changes?
Applying Professional Skepticism

**KEYS TO SUCCESS**

- Understand the management’s process
- Apply “what could go wrong” approach
- Investigate topics that may heighten your level of professional skepticism
- Watch for contradictory evidence
- Understand the economics and substance of process and transactions
What Skills Enhance Professional Skepticism?

**ESTABLISH ABILITY AND MINDSET**

- Analyze information
- Assess nature of the alleged misconduct
- Critically evaluate the situation
- Ask challenging questions
- Re-evaluate the previous positions
- Maintain objectivity and independence
Steps to Address Allegations of Fraud

- Make proper notifications (management, board, auditors, counsel)
- Be discreet and maintain privilege
- Isolate the suspect(s)
- Gather facts and secure electronic evidence
  - How long the activity has been occurring?
  - What is the financial impact of the activity?
  - Who knew about the activity?
  - What they did once they became aware of the activity?
- Retain subject matter experts
- Develop and execute investigative plan
- Reporting
Interviews of Employees and Targets

- Know your facts — including the background of interviewee
- Proper sequencing of interviews
- Proper sequencing of questions (talking points)
- Always have a witness and note taker
- Never make promises of confidentiality or leniency
- Ask for supporting documents
Employee Rights During Interviews

- Employees have differing rights during an investigatory interview depending on the employer/employee relationship.
- All employees have rights under Whistleblower protection laws.
- Investigatory interview occurs when a supervisor questions an employee to obtain information that could be used as a basis for discipline.
- The concept of “Getting off on a technicality” from criminal law also applies to employment.
The employment relationship between employer and employee will determine the employee’s rights.

**Public Employees**
- Investigations involving public employees must follow strict due process

**At-Will Employees**
- At-will employees typically have limited rights during investigatory interviews
- In 2004, the National Labor Relations Board ruled that non-union employees are not entitled to have a co-worker attend an investigatory interview
Examination and Analysis

Procedures frequently relied upon in conducting examinations include:

- Establishing a chronology of relevant events before and during the fraud
- Creating and maintaining a “fact sheet” that can be used as a quick reference of key individuals, organizations or events.
- Tracing transactions to source documents
- Analyzing financial results for unusual trends in revenue or expense accounts
Examination and Analysis (cont.)

- Analyzing individual transactions to find deviations in amount or procedure from the norm
- Identifying suspicious activity such as questionable wire transfers and bank accounts
- Analyzing correspondence (especially e-mails)
- Generating exception reports from systems (red flags)
Control Process Evaluations

In addition to addressing fraud at hand, it is also important to evaluate overall environment and existing controls for root causes:

- Poor tone at the top
- Unrealistic financial and/or performance expectations
- Non-compliance with laws and regulations
- Weak internal controls
- Poor oversight
- Segregation of duties
- Conflict of interest
Your investigation is only as good as your report.

- Written versus oral reports
- Understanding needs of stakeholders:
  - Board of directors
  - External auditors
  - Management
  - Legal Counsel
  - Law enforcement
  - Regulators
Discussion and Additional Q&A

Guler Ann Wiefling, CFE | Partner, Forensics and Litigation Services
Direct: 832.320.3480 | Email: guler.wiefling@weaver.com

Stephen Howard | Director, Forensics and Litigation Services
Direct: 832.320.7910 | Email: Stephen.howard@weaver.com