

SIG LESSONS LEARNED ALERT #19 - FY 2016 - 2017 FRAUD REPORT

Agency Heads & POCs,

Attached to this email is the SIG's "Annual Report of Fraud Conducted by Executive Branch State Employees--FY 2016-2017."

For a branch of government executing a \$26 billion budget with 60,000 employees, the low number of state employees reported for fraud (4) in four Executive Branch (EB) agencies was indicative of a high integrity work force. This was the lowest number of state employees reported for fraud and least number of EB agencies reporting fraud of the past four FYs. However, the FY 2016-2017 fraud losses of \$744,000 was the 2nd highest of the last four FYs. In each of the last four FYs there has been one major (six-figure) fraud to occur. FY 2016-17 was no different and in fact had the single largest fraud (\$650,000) of these four FYs. Any fraud undermines the public's confidence in State government, particularly in today's 24/7 news cycle. I encourage each agency to use the report in your fraud awareness training and the real life examples and lessons learned included in the report. Our greatest tool to prevent frauds or corrupt activity is raising the awareness of 60,000 pairs of eyes and ears & setting the expectation to report suspicious activity.

Thanks,

Brian D. Lamkin
State Inspector General

The State Inspector General's Annual Report of Fraud
Conducted by Executive Branch State Employees
Fiscal Year (FY) 2016-17

The State Inspector General (SIG) tracks fraud conducted by Executive Branch employees to assist state agencies in their investigations; serve as an indicator of integrity within the Executive Branch workforce; and transparently report to the public to maintain its confidence in the integrity of State government. At this time, the SIG does not track frauds conducted by third parties against the State, such as tax, Medicaid, pharmaceutical diversion, SNAP, or contract fraud, most of which are investigated by sworn law enforcement personnel residing in the respective state agencies.

The SIG identifies Executive Branch employee fraud through mandatory reporting by each agency; law enforcement reporting; agencies' annual reports to the Office of the Comptroller General; and open source reporting. In FY 2016-17, the SIG received four (4) notifications of fraud involving four (4) Executive Branch employees at four (4) state agencies, which resulted in estimated losses of \$744,000 in the below categories:

Fraud Scheme Category	Number of Reports	Fraud Losses by Scheme
Embezzlement/Misappropriation of funds	2 (50%)	\$94,000 (13%)
Contract/Grant Fraud	1 (25%)	\$650,000 (87%)
Kickbacks	1 (25%)	\$0
TOTALS	4	\$744,000

Below is a year-over-year comparison of past four FYs reported fraud schemes:

Fraud Scheme Category	FY 2016-17 Reported Incidents	FY 2015-16 Reported Incidents	FY 2014-15 Reported Incidents	FY 2013-14 Reported Incidents	FY 2016-17 Total Fraud Losses	FY 2015-16 Total Fraud Losses	FY 2014-15 Total Fraud Losses	FY 2013-14 Total Fraud Losses
Procurement Fraud	0	5	2	6	\$ 0	\$ 402,169	\$ 2,540	\$425,781
Contract/Grant Fraud	1	2	1	2	\$650,000	\$ 400,000	\$ 0	\$ 80,000
Embezzlement	2	4	4	1	\$ 94,000	\$ 376,360	\$362,410*	\$ 28,045
Theft	0	1	6	6	\$ 0	\$ 10,000	\$ 14,736	\$ 9,765
Bribery / Kickbacks	1	0	0	1+	\$ 0	\$ 0	\$ 0	\$ 0
Totals & Average Loss	4	12	13	16	\$744,000	\$1,188,529	\$379,686	\$543,591

*Initial payroll fraud scheme loss of \$256,527 was revised to \$337,410 at sentencing in 09/2016.

+Bribery scheme interrupted during federal wiretap investigation. No loss to the State.

Analysis of FY 2016-17 results developed the following observations:

- FY 2016-17 losses (\$744,000) were down 37% from the previous FY but slightly over the average of the three previous FYs (\$703,935). The FY 2016-17 incidents (4) were down 72% over the prior three FY average (13.6). This obviously resulted in a higher FY 2016-17 loss per incident of \$186,000 compared to the prior three FYs average of \$51,507.
- For FY 2016-17, the job levels for the four executive branch employees committing fraud were: two executive level employees (50%); one supervisor (25%); and one front line employee (25%). This represented the highest percentage of executive and supervisory level employees committing frauds over the past four FYs, by far, which logically correlates with higher fraud losses.

- Of the four fraud schemes reported, three of the cases were identified by co-workers reporting suspicious activity followed by discovery through routine audits.
- Of the four fraud schemes reported, one can be attributed to internal control gaps; two instances identified of the subject falsifying documents to override internal controls; and one instance where internal controls identified suspicious activity, which led to identifying the fraud.
- In FY 2016-17, for the fourth FY in a row, at least one fraud scheme (contract/grant fraud) has been significant in its estimated fraud loss (\$650,000).

The most illustrative “lessons learned” was gleaned from examining the major frauds of the past four FYs: (a) contract award fraud and kickbacks (\$400,000); (b) two procurement frauds (\$341,164); (c) embezzlement (\$336,000); and (d) contract/grant fraud (\$650,000). The common element was the subject(s) in each fraud were in management positions, which dramatically increased the fraud risk and potential loss. As a fraudster rises in management, it provides greater opportunity to override internal controls, access to larger funds/assets, and increases the ability to conceal by extending the length of the fraud, all of which lead to proportionally larger losses than schemes perpetrated by front-line employees.

These five frauds also reinforce the fundamental principles to prevent fraud: 1) raise employee awareness to report suspicious activity; and 2) managers properly executing routine existing internal controls in a thorough manner. Given the significant drop in reported incidents (4) for FY 2016-17 over the preceding three FYs, the SIG again takes note of the fact agencies may be underreporting fraud and choosing instead to terminate the employment of those found to have engaged in fraud against the state agency without further consequence. This gives credence to the anecdotal claims by some statewide internal auditors that agencies are underreporting fraud with the respective agency.

In summary, the four fraud incidents totaling \$744,000 indicate a low risk of employee fraud in the Executive Branch given its \$26 billion budget and 60,000 employees. However, for the fourth year in a row there has been at least one major fraud in the six-figure range (\$650,000) along with nominal frauds which should be noted by Agency Heads and financial managers. A major fraud can potentially damage an agency’s reputation and undermine the public’s confidence in the Executive Branch. State government agencies are essentially a large partnership, where a negative event caused by one agency has the tendency to undermine the public’s confidence in all State agencies.

ADMINISTRATIVE NOTE: Vignettes describing the four frauds during FY 2016-17 can be found at the following link:
<http://oig.sc.gov/Documents/VIGNETTES-Fraud-2016-17-Final.pdf>