

The State Inspector General’s Annual Report of Fraud
Conducted by Executive Branch State Employees
Fiscal Year (FY) 2018-19

The State Inspector General (SIG) tracks fraud conducted by Executive Branch employees against state agencies to assist these agencies in their investigations; serves as an indicator of integrity within the Executive Branch workforce; and transparently reports 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; the Office of the State Auditor; and open source reporting. In FY 2018-19, the SIG received seven (7) notifications of potential fraud involving seven (7) Executive Branch employees at five (5) state agencies, which resulted in estimated losses of \$2,906 in the below categories:

| Fraud Scheme Category | Reported Incidents | Fraud Losses by Scheme |
|-----------------------|--------------------|------------------------|
| Procurement Fraud | 2 (29%) | \$0 |
| Theft of Funds | 1 (14%) | \$1,400 |
| Fleet Card Fraud | 3 (43%) | \$1,506 |
| Contract/Grant Fraud | 1 (14%) | \$0 |
| TOTALS | 7 (100%) | \$2,906 |

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

| Fraud Scheme Category | Reported Incidents | | | | Total Reported Losses | | | |
|---|--------------------|------------|------------|------------|-----------------------|----------------|------------------|--------------------|
| | FY 2018-19 | FY 2017-18 | FY 2016-17 | FY 2015-16 | FY 2018-19 | FY 2017-18 | FY 2016-17 | FY 2015-16 |
| Procurement Fraud | 2 | 1 | 0 | 5 | \$0 | \$0 | \$0 | \$402,169 |
| Contract/Grant Fraud | 1 | 0 | 1 | 2 | \$0 | \$0 | \$650,000 | \$400,000 |
| Embezzlement | 0 | 2 | 2 | 4 | \$0 | \$2,252 | \$94,000 | \$376,360 |
| Theft of Funds | 1 | 1 | 0 | 1 | \$1,400 | \$29 | \$0 | \$10,000 |
| Bribery / Kickbacks | 0 | 0 | 1 | 0 | \$0 | \$0 | \$0 | \$0 |
| Conflict of Interest/ Business Relationship | 0 | 1 | 0 | 0 | \$0 | \$0 | \$0 | \$0 |
| Fleet Card Fraud | 3 | 0 | 0 | 0 | \$1,506 | \$0 | \$0 | \$0 |
| Totals | 7 | 5 | 4 | 12 | \$2,906 | \$2,281 | \$744,000 | \$1,188,529 |

Analysis of FY 2018-19 results developed the following observations:

- FY 2018-19 losses (\$2,906) were up 27% from the previous FY but more than 99% below the average of the three previous FYs (\$645,000). This total may increase once the criminal investigation in one matter has concluded and the final loss is determined. The FY 2018-19 incidents (7) were consistent with the average of the three prior fiscal years (7). The average reported loss per fraud for FY 2018-19 was \$415 as compared to the prior three fiscal years' average of \$92,133.
- For FY 2018-19, the job levels for the six executive branch employees reported for fraud were three supervisory level employees (43%) and four front line employees (57%).
- Of the seven fraud schemes reported, two cases were identified through external (non-state employees) sources reporting suspicious activity.
- Five of the seven fraud schemes reported are attributed to internal control gaps and lack of adherence to internal policies and state regulations.

A common element found in the reported frauds for the past four fiscal years was lax internal controls. 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 seven 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 decline in reported frauds over the past three fiscal years, 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 is a common claim made by some statewide internal auditors.

In summary, the seven fraud incidents totaling \$2,906 indicate a low risk of employee fraud in the Executive Branch given its \$24.8 billion dollar budget and 60,500 employees. Although no major fraud in the six-figure loss range was reported, agency heads and financial managers should take note of smaller fraud schemes as potential weaknesses in internal controls. 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: Included with this report are vignette summaries of the five reported fraud matters, as well as a recap of lessons learned from SIG investigations and reviews during FY 2018-19.

VIGNETTES – Fraud Conducted by Executive Branch State Employees in FY 2018-2019

1. The SIG received an external complaint that a supervisory employee at a state agency, after fueling his/her assigned state vehicle, was observed handing the fuel pump nozzle to an individual, later identified as the employee's relative. At that time, it was alleged the employee's relative placed fuel into a non-state vehicle while utilizing the agency's fuel purchase card. A SIG investigation determined the employee's vehicle logs were not accurately kept and gas records showed the thefts happened several times over approximately one and a half years. The employee was terminated from state employment. Prosecution was declined in the matter. The internal control weakness identified was a lack of management oversight. Total fraud loss identified: \$74.34.
2. A state agency's internal audit group identified an employee of the agency removed fuel purchase cards from various agency vehicles and fueled vehicles at in-state and out-of-state locations. The audit determined no agency business was conducted at the out-of-state locations. The employee was later identified as having fueled his/her personally owned vehicle. This matter was further investigated by law enforcement and resulted in the employee's termination and arrest. The internal control weakness identified was a lack of management oversight. Total fraud loss identified: \$1,400.00.
3. An external complaint to a state agency resulted in an internal audit by the agency, which identified an agency employee took fuel purchased by the agency and placed the fuel into personal fuel containers and into the employee's non-state personally owned vehicle. The matter was investigated by law enforcement. The internal control weaknesses identified was a lack of managerial oversight. Total fraud loss identified: \$32.15.
4. Two supervisory employees of a state agency were assigned agency purchase/credit cards for use in performance of their duties. The employees developed a relationship with a service vendor who provided false invoices for completed work when in fact no work was done. When the vendor received payment, it was divided with the state employees. The internal control weaknesses identified were the failure to properly oversee purchases of services and lack of verification the work was completed, as well as failure to follow agency policies and procedures. This matter is currently being investigated by law enforcement. Total fraud loss identified at present (Investigative results pending): \$0.00.
5. An employee of a state agency devised a scheme where the employee claimed to be in the position of providing a program certification to external customers for a fee, which was stipulated to be payable only in cash. The scheme was discovered when a customer didn't receive the certification and complained to the agency. The agency reviewed the matter and referred it to law enforcement, which resulted in the employee's arrest and termination. No internal control weakness was identified as the employee acted outside of the scope of duties for his/her position. Total fraud loss identified: \$1,400.00.

6. An internal audit conducted by a state agency that administers state and federal grants identified discrepancies in a sub-grantee's reported expenditures required under the terms of the grants. No actual loss has been identified at this time. Total fraud loss identified: \$0.00.

7. An state agency employee was observed placing fuel from an agency fuel pump into his/her personal vehicle. In addition, an audit of the employee's purchase card activity was conducted, which showed several questionable purchases that could not be verified as being either agency related or personal in nature. The employee was terminated. The internal control weakness identified was lack of managerial oversight over the employee's use of the agency's purchase card. Total fraud loss identified: \$0.00.

Recap of Lessons Learned for Fiscal Year 2018-19

Cross-training & Secondary Staffing – The SIG identified deficiencies in key processes and program functions at two EB agencies when key processes and functions were assigned to a singular individual. Subsequent employee departures from the agencies and failure to timely transfer the knowledge and program processes, in turn negatively impacted the agencies’ program performance and delivery of services to its clients. Agencies should consider cross-training key employee functions, and identify and assign secondary staffing to these key processes to ensure the uninterrupted transfer of knowledge to key agency personnel, and the processes remain uninterrupted through absences and/or employee departures.

Internal Controls & Separation of Duties – A common observation found was in purchasing and accounts payable areas of an agency’s financial operations. This includes weak supervisory oversight of employees in these areas.

Procurement Conflict of Interest – Transparency and full disclosure of employees involved in the procurement process is paramount to the integrity in government operations. Procedures should be in place to ensure any actual or perceived conflict of interest is fully disclosed to procurement officials and agency decision-makers throughout the procurement process. These procedures should also pertain to and incorporate oversight of third-party vendors utilized by agencies to assist in proposal development.

Internal Standard Operating Procedures – Maintaining current policies and procedures is imperative to the operations and management of an agency and its employees. Agencies should develop and maintain updated internal procedures governing its processes for the management and control of the organization.

Contract/Grant Management – Three of the 24 previously issued “lessons learned” alerts (#1, 13, and 17) have pertained to state agencies providing proper contract/grant management and oversight. The SIG determined during the course of conducting program reviews in FY 2018-19 of the need to re-issue a fourth alert to EB agencies pertaining to contract/grant management. State agencies should ensure all staff involved in the oversight of contracts, and in particular, federal grants are trained and knowledgeable of the contracts and grant agreements, requirements, deliverables, and the applicable state and federal regulations governing these agreements. Failure to provide proper oversight and reporting, in particular for federal grant funding may expose the agency and the state to a recapture of funds improperly expended under the contract or grant parameters.