

The State Inspector General's Annual Report of Fraud
Conducted by Executive Branch State Employees
Fiscal Year (FY) 2017-18

The State Inspector General (SIG) tracks fraud conducted by Executive Branch employees against state agencies to assist these 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; the Office of the State Auditor; and open source reporting. In FY 2017-18, the SIG received five (5) notifications of potential fraud involving five (5) Executive Branch employees at five (5) state agencies, which resulted in estimated losses of \$2,281 in the below categories:

Fraud Scheme Category	Reported Incidents	Fraud Losses by Scheme
Embezzlement/Misappropriation of funds	2 (40%)	\$2,252 (99%)
Conflict of Interest – Business Relationship	1 (20%)	\$0
Procurement Fraud	1 (20%)	\$0
Theft of Funds	1 (20%)	\$29 (1%)
TOTALS	5 (100%)	\$2,281 (100%)

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

Fraud Scheme Category	Reported Incidents				Total Reported Losses			
	FY 2017-18	FY 2016-17	FY 2015-16	FY 2014-15	FY 2017-18	FY 2016-17	FY 2015-16	FY 2014-15
Procurement Fraud	1	0	5	2	\$0	\$0	\$402,169	\$2,540
Contract/Grant Fraud	0	1	2	1	\$0	\$650,000	\$400,000	\$0
Embezzlement	2	2	4	4	\$2,252	\$94,000	\$376,360	\$362,410
Theft of Funds	1	0	1	6	\$29	\$0	\$10,000	\$14,736
Bribery / Kickbacks	0	1	0	0	\$0	\$0	\$0	\$0
Conflict of Interest/ Business Relationship	1	0	0	0	\$0	\$0	\$0	\$0
Totals	5	4	12	13	\$2,281	\$744,000	\$1,188,529	\$379,686

Analysis of FY 2017-18 results developed the following observations:

- FY 2017-18 losses (\$2,281) were down more than 99% from the previous FY and more than 99% below the average of the three previous FYs (\$770,738). The FY 2017-18 incidents (5) were down

48% over the average of the three prior fiscal years (9.7). The average reported loss for FY 2017-18 was \$456 as compared to the prior three fiscal years' average of \$79,732.

- For FY 2017-18, the job levels for the five executive branch employees reported for fraud were: one senior manager/division director level employee (20%) and four front line employees (80%).
- Of the five fraud schemes reported, two of the cases were identified by external (non-state employees) sources reporting suspicious activity.
- All five of the fraud schemes reported can be 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 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 sharp decline in reported frauds (5) for FY 2017-18, 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 that agencies are underreporting fraud at their respective agency.

In summary, the five fraud incidents totaling \$2,281 indicate a low risk of employee fraud in the Executive Branch given its \$27 billion budget and 60,000 employees. However, although there was not one major fraud in the six-figure range, nominal frauds 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: 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 2017-18.

VIGNETTES – Fraud Conducted by Executive Branch State Employees in FY 2017-2018

1. An employee of a state agency was alleged to have created a fake account at the agency and generated a check from agency funds made payable to the employee's spouse and placed into a bank account maintained by the spouse. This accounts payable fraud scheme was investigated by law enforcement and resulted in the employee's arrest and state employment termination. The internal control weakness identified was a lack of management oversight. Total fraud loss identified: \$1,522.00.
2. An employee of a state agency resigned from state employment due to a personnel matter. A post-employment audit of the employee's files was conducted by the agency and it was determined that monies paid by agency clients to the employee were missing. This matter was further investigated by law enforcement and resulted in the employee's arrest. The internal control weakness identified was a lack of management oversight. Total fraud loss identified: \$730.00.
3. An external complaint to a state agency resulted in an internal audit by the agency, which identified questionable procurement practices by an employee of the agency, who also worked part-time as an office assistant at a private business, without agency approval. The internal control weaknesses identified were failure of managerial oversight, separation of the duties, and authority for the purchasing of supplies. Total fraud loss identified: \$0.00.
4. An employee of a state agency was alleged to have a conflict of interest in a procurement matter at the agency. Investigation by the SIG determined that the agency had poor documentation practices, which gave the procurement the appearance of a conflict of interest. The internal control weaknesses identified were the failure to properly document the procurement file and properly use the procurement code, agency policies and procedures. There was no conflict of interest by the employee. Total fraud loss identified: \$0.00.
5. An employee of one state agency was observed by employees of another state agency putting gas into a personally owned vehicle at state fuel pumps. The employee had access to the agency's vehicles and agency fuel cards, with minimal oversight. This matter is being investigated by law enforcement. The internal control weakness identified was a lack of oversight over the use of agency credit cards. Total fraud loss identified: \$29.00

Recap of Lessons Learned for Fiscal Year 2017-18

1. Outside Employment Policy – The failure to obtain approval for outside employment by a state employee was a common finding in several of the reviews conducted by the State IG during FY 2017-18. When interviewed most were unaware of the need to obtain prior approval from the employee’s supervisor or unfamiliar with the agency’s policy altogether.
2. 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.
3. Procurement File Documentation – The Consolidated Procurement Code requires proper documentation in procurement matters. Not only is this important in the awarding and potential protests common in state procurements, but more so when allegations of conflicts of interest are made against state employees involved in procurement matters.
4. Contract/Grant Management – Ensure deliverables and proper documentation are in hand before disbursing funds. While this is a fundamental element of contract/grant management the SIG observed mistakes in this area during FY 2017-18.
5. Fundamental Principles to Prevent Fraud – Raise employees awareness to report suspicious activity; and managers properly executing routine existing internal controls in a thorough manner.
6. Top Six (6) Behavioral Red Flags of Potential Employee Fraud – Living beyond means; financial difficulties; unusually close association with customer/vendor; control issues – unwilling to share duties; family problems; and “wheeler-dealer” attitude.
7. Top Three (3) Anti-Fraud Controls – Code of Conduct; external audit of financial statements; and an internal audit department. While all agencies have a code of conduct or ethics policy, it should include annual employee training that reiterate the “do’s and don’t’s.”