

# The Creative Fraudster



# Purpose of presentation

- Reminiscences of a fraud investigation
- How the investigation changed Internal Audit's perspective and my ideas of how to be a successful Internal Auditor



# Names are omitted....

- Most people involved with this fraud and investigation are no longer at the former university
- Internal Audit and the University's Leadership have worked to change the culture



# Private University Culture

Private Universities tend to have a different focus from public universities:

- Donor Relations
- Public Image of how we compared with other Universities
- Not a Research University so there is not a big focus on Federal Award requirements



# Tone at the Top

- President received little oversight by the Board of Regents
  - The \$100 Million “Gift” (Charitable Remainder Trust)
- Excessive Salaries
- “University Condo”



# Tone at the Top

- Out of control spending on travel and entertainment by President and Deans
  - First Class Air Travel
  - Expensive Hotels
    - “You have to spend money to make money...”



# The small audit department

- Audit Director and Senior Auditor
  - Audit Director managed special projects requested from Campus Leadership and Regents
  - Senior Auditor completed the audit plan
- We completed 3 – 4 audits per year



# The small audit department



- “We have an audit department?” – Very little impact on campus
- Avoided the “political” areas (Regents involved in Conflicts of Interest, Executive Compensation, Business Trips that looked like vacations, etc.)



# Does Internal Audit Really Help?

## Typical Internal Audit Cycle

1. Auditor identifies control weaknesses
2. Recommended changes are not implemented or new procedures don't cover identified risk
3. Different auditor completes same audit and identifies the same control weaknesses



# Experimenting with Data Analytics

- The former Audit Director had purchased ACL and then left without using it
- Purchase Card Transactions
  - Easy to download
  - All backup documentation was in the basement of the Finance Center
- Uploaded prior fiscal year transactions



# Review of Purchase Card Transactions

Some of the crazy things we noted:

- Very expensive plane tickets and hotel stays
- Lots of pizza and groceries purchased on weekends by Student Life
- Trips to golf resorts (golf team)
- Trips to expensive conferences
- Some employees were having “business lunches” every day
- String of amounts paid to a PayPal vendor called “Image Systems”

# Image Systems

- We noted around \$25,000 worth of PayPal transactions to one vendor – “Image Systems”
  - All of the PayPal transactions were by various P-Cards in the same department
  - Transactions were charged to “Copy Services”
- According to the invoices, Image Systems was a local copying service that bound and copied reports to grantors
- Did it make sense for a small research department to spend this much to print reports?



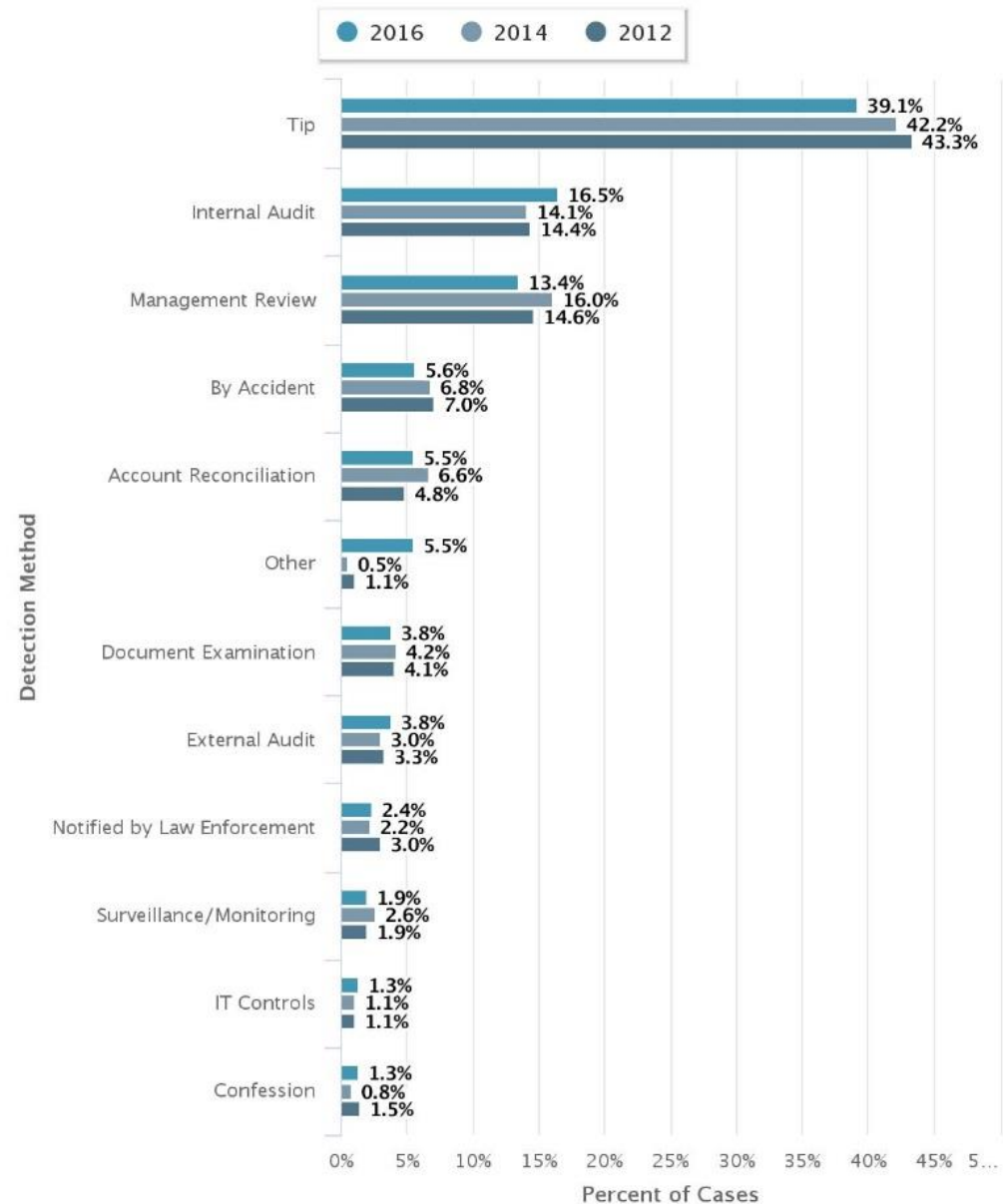
# Image Systems

- Local business paid via a PayPal account
- The invoices seemed very simplistic
- The vendor had a PO Box and there was nothing online regarding the vendor
- We eventually determined that it was a phony vendor
  - Vendor had a local PO Box as the address which did not exist

[Company Name]	<b>INVOICE</b>										
[Street Address] [City, ST ZIP] Phone: (000) 000-0000											
	<table border="1"><thead><tr><th>INVOICE #</th><th>DATE</th></tr></thead><tbody><tr><td>[123456]</td><td>5/1/2014</td></tr></tbody></table>	INVOICE #	DATE	[123456]	5/1/2014						
INVOICE #	DATE										
[123456]	5/1/2014										
<b>BILL TO</b>											
[Name] [Company Name] [Street Address] [City, ST ZIP] [Phone] [Email Address]											
<table border="1"><thead><tr><th>DESCRIPTION</th><th>AMOUNT</th></tr></thead><tbody><tr><td>Service Fee</td><td>200.00</td></tr><tr><td>Labor: 5 hours at \$75/hr</td><td>375.00</td></tr><tr><td>New client discount</td><td>(80.00)</td></tr><tr><td>Tax (4.25% after discount)</td><td>26.56</td></tr></tbody></table>	DESCRIPTION	AMOUNT	Service Fee	200.00	Labor: 5 hours at \$75/hr	375.00	New client discount	(80.00)	Tax (4.25% after discount)	26.56	
DESCRIPTION	AMOUNT										
Service Fee	200.00										
Labor: 5 hours at \$75/hr	375.00										
New client discount	(80.00)										
Tax (4.25% after discount)	26.56										
<i>Thank you for your business!</i>	<b>TOTAL \$ 551.56</b>										
If you have any questions about this invoice, please contact [Name, Phone, email@address.com]											
Invoice Template © 2014 Vertex42.com											

# ACFE's Fraud Detection Statistics

Initial Detection of Occupational Frauds



# Totally Unprepared for Fraud Discovery

- What do we do?
- Met with campus police who contacted the local District Attorney
  - We were told the DA would move forward with the fraud case if more than \$50,000 was stolen
- Reviewed insurance policy for coverage for employee theft
  - Reimburse for cost of investigation



# Overview of Research Department (ORU)

- Director / Principal Investigator was a very busy guy
  - Spent 50% of time at the University and rest of his time at a National Lab
- Grants from State of California and other state agencies
- Director managed two staffs of researchers and graduate students





# Environmental Engineering Research Project



- Part of Engineering department
- Main research project related to reviewing water runoff into the San Joaquin Delta and rivers
- Most of researchers were usually off-site and the department had very little interaction with others

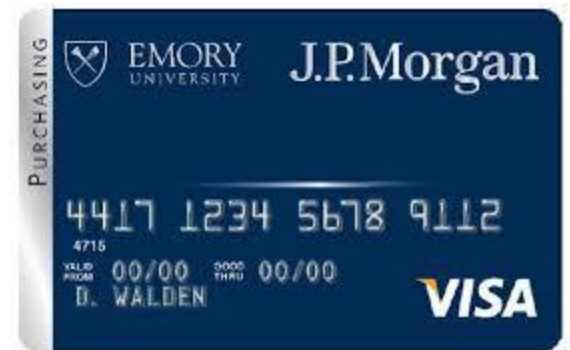
# Meeting with the Director

- Overview of who did what in the department
- Director was a scientist who did not have time for administrative stuff
  - All financial responsibilities and review had been “delegated” to the Business Manager
- The Approval Signature for the monthly purchase card statements



# The Very Helpful Business Manager

- Business Manager handled all of the department's purchasing, review of financial information, grant reporting, etc.
- "A great employee" who got along well with everyone and always had good annual reviews
- She went out of her way to be helpful by taking on all of the financial responsibilities of the other employees in the department
  - She put together all of the monthly documentation for each of the department's purchase card holders
  - She collected all of the department's timesheets and delivered them to payroll
  - Other department employees didn't even realize they were responsible for their P-card documentation



# The Fraud Investigation

- How can someone without direct access to cash embezzle?
- Review EVERYTHING
  - Contacted IT Security Officer to obtain last five years of emails
  - Scrutinized every transaction by the department over many years
  - Identified all transactions she was involved with
  - Reviewed her paper timesheets since she arrived at university
  - Identified all of the ways she posted information on the internet
    - Facebook
    - Website where she posted pictures

# Things we learned about the Business Manager

- She earned around \$40,000 per year, but drove a new BMW with the license plate "GOT BMR"
  - The day she bought the car, she e-mailed pictures of it to the whole department
- She had a boat and jet skis (which she was always happy to lend to anyone)
- Took expensive vacations
- Many weekends she was traveling all over California with her daughter's sports team
- She was paying mortgages on two houses
- Always seemed to be struggling financially
  - Sometimes asked friend for loan to pay bills



# Getting to the \$50,000 Threshold

- No time pressure
- We spent months reviewing and identifying the many ways that the Business Manager was stealing from the University
- “If she had only been this creative in her daily work...”



# Different Frauds

- Purchase cards
- Phony Vendors
- Phony Reimbursements
- Petty Cash
- Overtime claimed but not worked
- Vacation charged as sick time (not included in the fraud amount)

# Purchase Card Frauds

- Funneling money to herself by paying vendors she set up
  - PayPal
  - Other online payment processor
- Personal Purchases
  - Premium Gasoline for the boat
  - Video games and other items









# Overtime

- Began getting a Business Manager in another department to approve her timesheets as Director was too busy
- Claimed she was working crazy hours and most weekends
- Posted pictures of weekend games and vacations



# Vacation vs. Sick Time

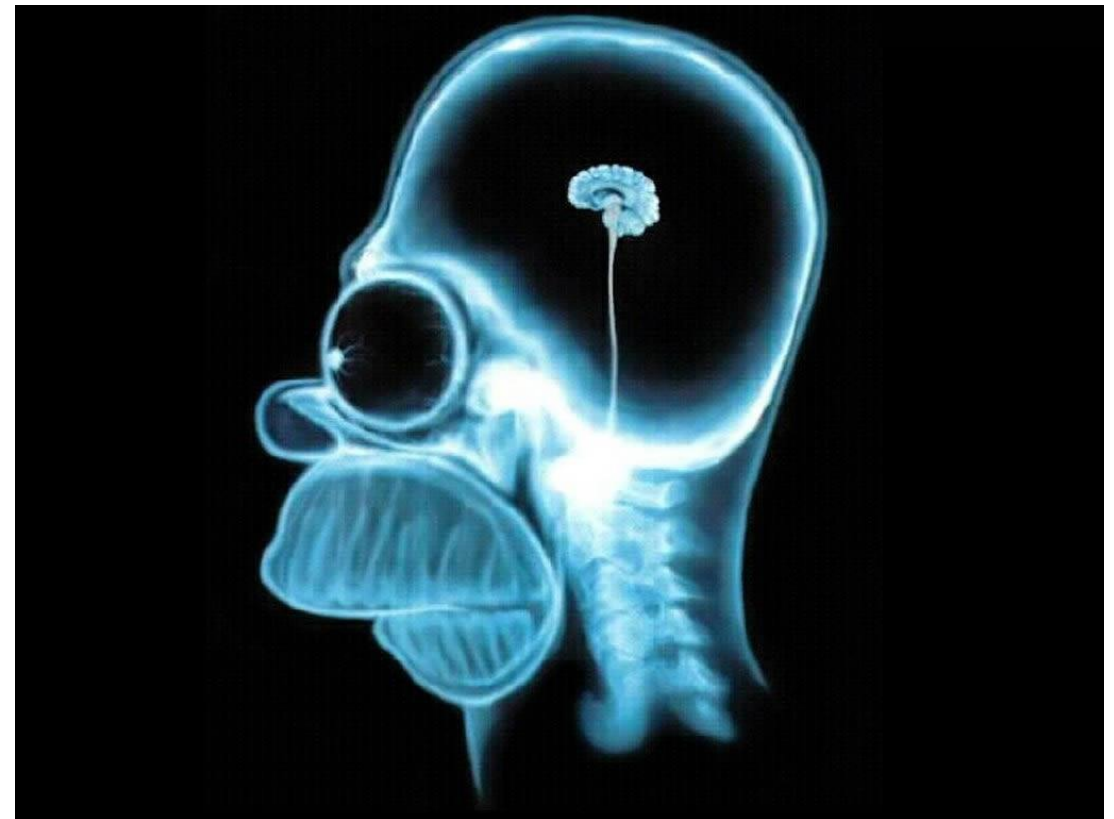
- The Business Manager would request vacation time
- The Director would approve the time off via email
- She would then record the time as sick time
- She was close to maxing out her vacation time when she was laid off from the Research Department





# Others Involved?

- Suspicion began to fall on other employees
- Part of the schemes or incompetent?
  - Timesheet approvals
  - Accounts Payable
  - Supervisors
- Just never considered that it might be fraud...



# Overview of Investigation Results

- After committing these frauds for years, she hardly even bothered covering up the fraud during the last months
- We combed through documentation for three months and put together binders full of the fraud examples we identified
- Determined that we could positively say that Business Manager had stolen \$66,000
  - We believe there was much more, but we couldn't adequately prove it

# Difficult Decisions

Decision #1 - Should the University fire her or continue to monitor how she is stealing?



# Difficult Decisions

Decision #1 - Should the University fire her or continue to monitor how she is stealing?

**Controller's Office** – “Are you crazy? She’s outsmarted us for years and you think it would be safe to keep her around?”

# Difficult Decisions

Decision #2 – What should we tell people when employees ask why this popular employee has been fired?

# Difficult Decisions

Decision #2 – What should we tell people when employees ask why this well-known employee has been fired?

**VP – Business and Finance** – “Let’s make an example of her by sending out an announcement about why she was fired.”

In a strange way, Leadership finally told employees: “We care about ethics and this behavior will not be tolerated”



# Timeline of events

- **2004** – Hired by university
- **2005 - 2008** – Fraudulent transactions in Research program
- **Fall 2008** – Grant runs out of funding so fraudster is laid off and is rehired by Student Housing
- **Spring 2009** – Begins changing timesheets to show overtime not worked
- **Fall 2009** – Internal Audit stumbles upon fraudulent transactions from 2008
- **November 2009 – January 2010** – Preliminary Investigation causes employee to be terminated
- **February 2010** – Announcement goes out that employee was fired for fraud
- **July 2010** – Former employee arrested
- **January 2011** – Former employee pleads guilty to charges

# Final Results of Investigation



## Former Pacific clerk pleads guilty to embezzling \$66,000

BY THE RECORD  
FEBRUARY 25, 2011

STOCKTON - A former University of the Pacific clerk pleaded guilty to embezzling \$66,000, San Joaquin County Deputy District Attorney Stephen Taylor has said.

Bernadette Canales-Alvarado, 34, worked at Pacific from 2005 to 2008 in the university's Ecological Engineering Research Program. She illegally paid herself, bought gas for her car and improperly reported overtime, Taylor said.

An audit alerted university officials of the theft and resulted in her being fired.

Canales-Alvarado pleaded guilty Wednesday to one count of theft of public funds, and she could spend time in state prison. San Joaquin County Superior Court Judge Franklin Stephenson is expected to sentence her in May.

By a stroke of luck, Internal Audit discovered the university's only dishonest employee...

# Other 2010 Frauds and Investigations

After the discovery of this first fraud, we began receiving anonymous tips from other employees which lead to other investigations:

- Discovered that a Dental clinic manager had stolen around \$120,000 in patient fees between 2004 and 2010
- A Dean's administrative assistant stole around \$65,000 from the student honors society, for which she managed the finances
- Discovered that a former audiology clinic manager received \$25,000 worth of kickbacks from a vendor
- A Director hired his fiancé in his department. Employee spent most of her time at work planning the wedding. He also brought her along on business trips and charged her travel expenses to the University.
- Business Manager of Physical Plant and Support Services stole around \$6,000 worth of cash from the University

# One Fraud Internal Audit Missed

**“Ex-student treasurer accused of embezzling from Pacific sorority” –**  
Stockton Record Headline

A Union City resident, Lina Lee, 39, is wanted on suspicion of taking as much as \$114,507 from the Alpha Phi, Iota Gamma Chapter. The arrest warrant declaration says she may have paid back all but \$38,756.

In an interview with Stockton Police Detective Luis Mosqueda, Lee said that while keeping the chapter's books she paid her landscaper, made personal loans from the sorority's bank and wrote checks to cash, the arrest warrant says.

She used the sorority's money because "it was more convenient" than using her own money, and she may have "lost track" of the amount she actually took, the detective said.



- Around \$280,000 worth of fraud was identified by Internal Audit
- Submitted various employee theft claims to the insurance company



# What we learned

1. Committing fraud will ruin your life
2. Learn to think like a fraudster - there are people who will exploit control weaknesses
3. Tone at the Top really matters

# Fraud – It's never worth it

- What's your price?
- You will never have peace (unless you're a psychopath)
  - Dean's Assistant who finally took a vacation
  - Information in the financial system

“Such are the paths of all who go after ill-gotten gain; it takes away the life of those who get it.”

– Proverbs 1:19



# Think like a Fraudster

- Your role is to ask “If I was going to commit fraud against this organization, how would I do it?”
- Then evaluate whether controls are in place to prevent the fraud
- Realize there are probably others out there who are actively exploiting the weaknesses



# Importance of Tone at the Top



Recent work by Dan Ariely

TED Talks – “Our Buggy Moral Code”

Story about the importance of a sweatshirt – Pitt vs. Carnegie Mellon

Whether you like it or not - You and Campus Leadership set expectations for cheating and fraud

# Impact on Internal Audit

- Department grew 50% (1 additional FTE)
- Change in focus
  - Get out and understand what departments do!
- To simplify Internal Audit, you need to:
  - Understand people, their roles and responsibilities
  - Understand transactions and how money flows through the campus



# Understanding People and What They Do

- Get out there and meet people
- It is never a waste of time for you to spend time with employees from other departments
  - Meetings
  - Events



# Understanding Transactions

- Get into the financial system and understand how money flows through the university
  - Inflows – Tuition, Financial Aid, Donations, Special Events
  - Outflows – Employee compensation, payments, purchase cards, etc.
- Why Internal Audit should be involved with Data Analytics
  - Management vs. Internal Audit Roles



# Continuing Impact of Internal Audit

- Former Audit Director retired during 2013
- New Campus Leadership and New Audit Director have worked to change the culture





# Summary

- Tone at the top matters
- To be a good auditor, you need to understand the organization (so you can identify when something looks weird)

