



*cutting through complexity*

# Fraud and Misconduct in the Public Sector

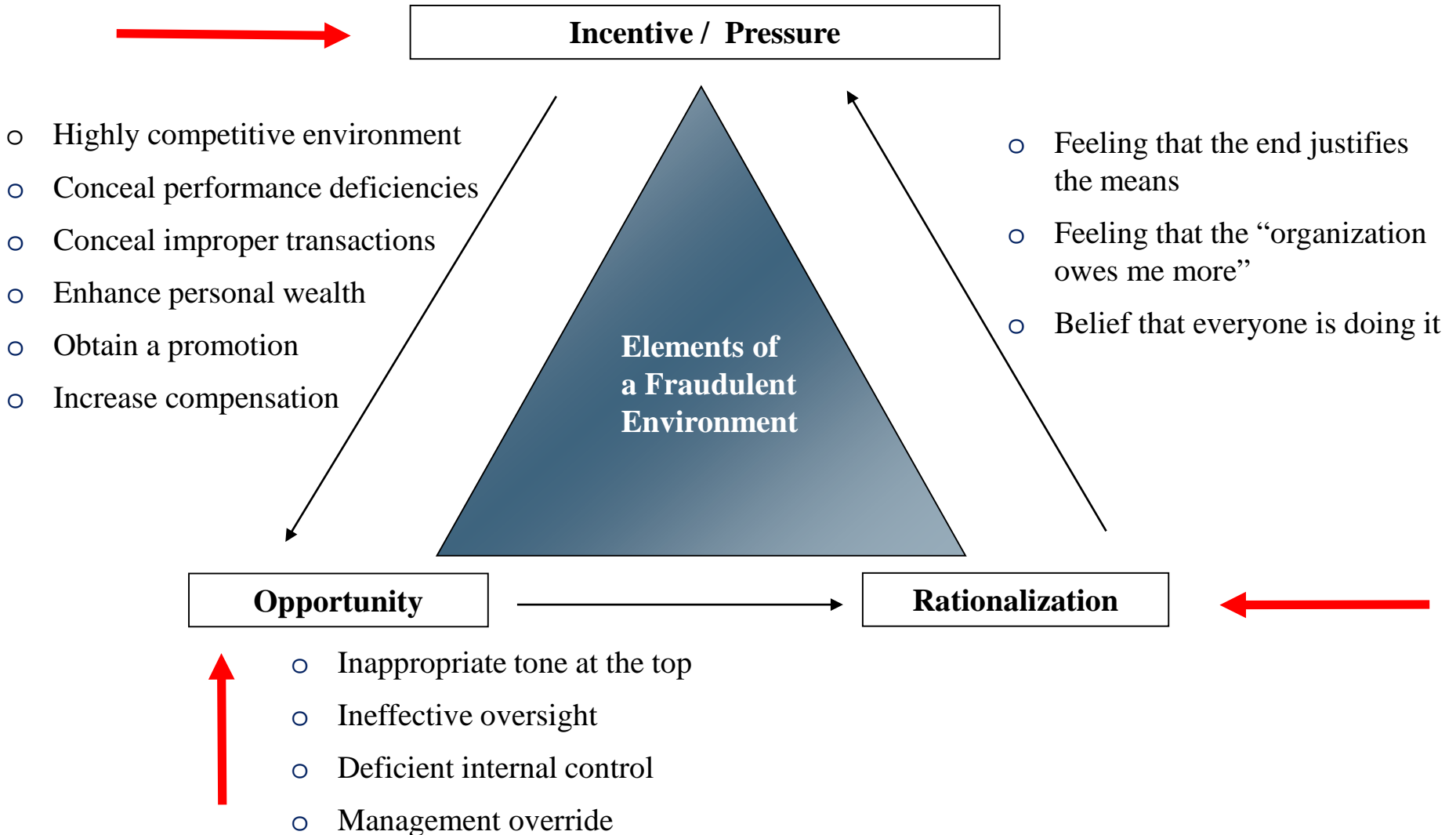
Douglas Farrow, Partner

# Fraud in the Media – Recent Headlines

Recent headlines from local news media of public agency fraud and misconduct:

- *December 8, 2016, Los Angeles Times: **FBI investigates allegations of embezzlement against Compton’s deputy treasurer***
- *July 28, 2016, Los Angeles Times: **“Envelopes stuffed with cash: South El Monte mayor admits to taking bribes from a city contractor”***
- *July 20, 2016, Ventura County Star: **“Former Thousand Oaks city manager fired for dishonesty, documents show”***
- *May 31, 2016, KHTS AM 1220: **“A Santa Clarita employee has been accused of stealing more than a half-million dollars from city coffers by writing phony invoices”***
- *May 17, 2016, Banning-Beaumont Patch: **“Six Jailed in \$43 Million Beaumont Public Corruption Case”***
- *April 14, 2016, Los Angeles Times: **“Placentia financial manager arrested, accused of embezzling \$4.3 million from city”***
- *April 13, 2016, Southgate-Lynwood Patch: **“Former Lynwood City Employee Charged With Embezzling Employees’ Union Funds ”***
- *March 18, 2016, Pasadena Now: **“Ex-Pasadena City Employee, Two Others to Stand Trial for Alleged Embezzlement”***

# Fraud Triangle



# Common Fraud Types

## Misappropriation of Assets

- Procurement fraud
- Payroll and pension fraud
- Expense fraud
- Theft of entity funds and property
- Falsification of timesheet information
- Forged cheque signatory

## Other Misconduct and Fraud

- Bribery and corruption
- Conflict of interest
- Kickbacks/gifts
- Bid rigging
- Supplier favoritism

## Fraudulent Financial Reporting

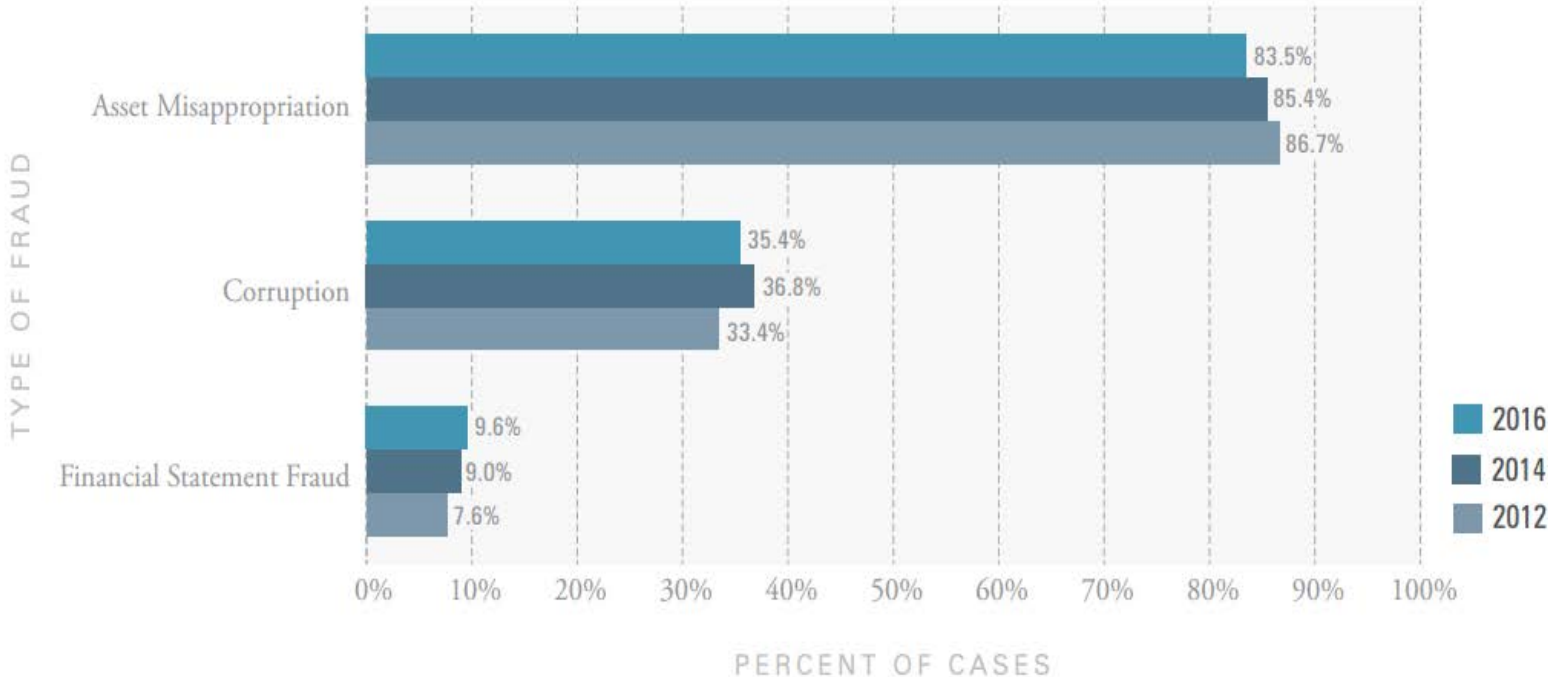
- Improper revenue recognition
- Understatement of expenses
- Overstatement of assets
- Conceal liabilities / expenditures
- Omission / improper disclosures
- Deliberate misapplication of accounting standards

## Cost & Impact of fraud:

- Jeopardizes the entity's welfare
- Diversion of management resources
- Cost of external resources
- Damage to organization's reputation and image
- Negative impact on service delivery
- Negative impact on morale
- Possible loss of valuable staff members
- Loss of confidence
- Financial loss

# Prevalence by Fraud Type

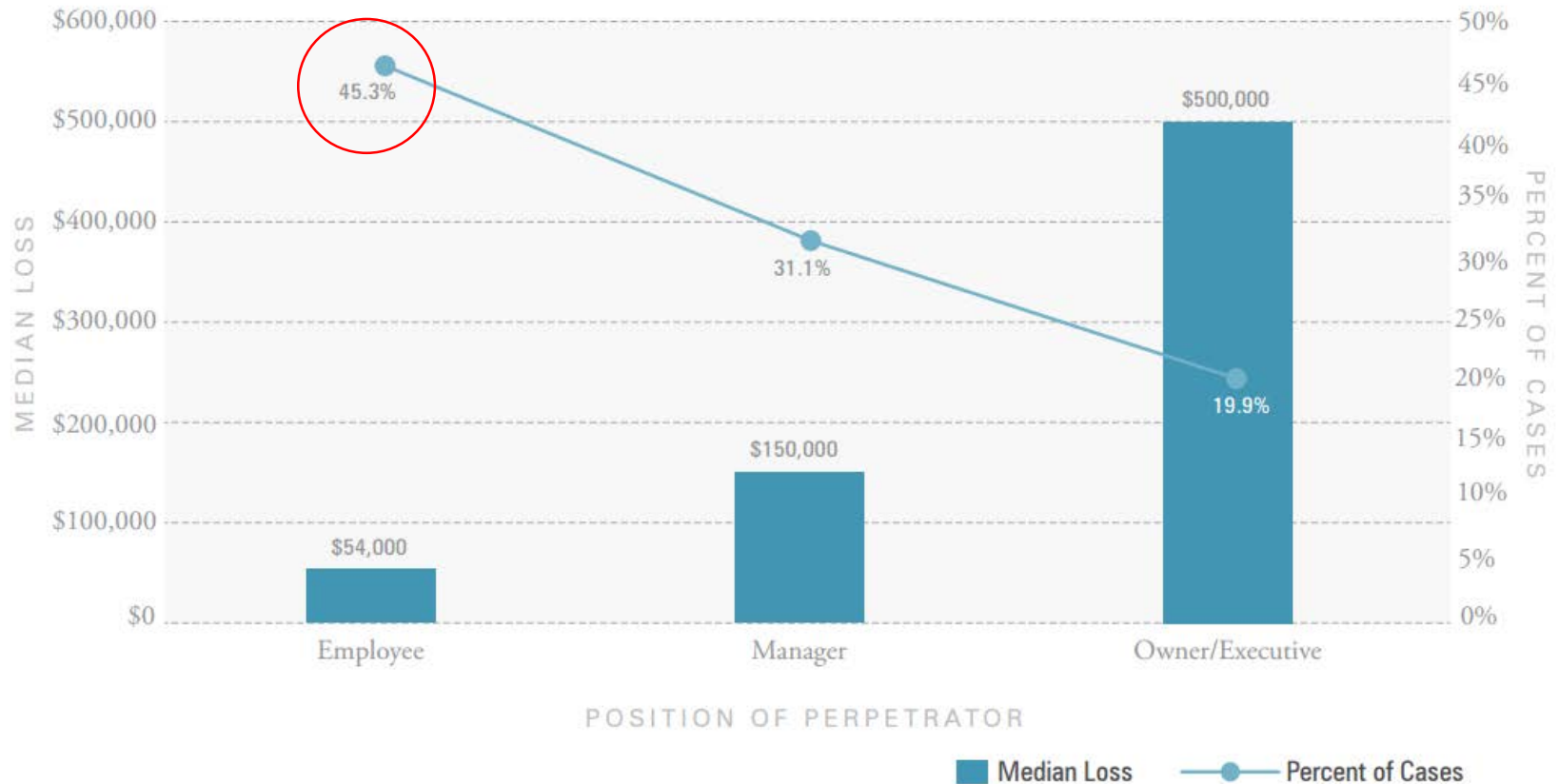
Figure 4: Occupational Frauds by Category—Frequency



Source: 2016 Association of Certified Fraud Examiner Report to the Nations on Occupational Fraud

# Position of Perpetrators

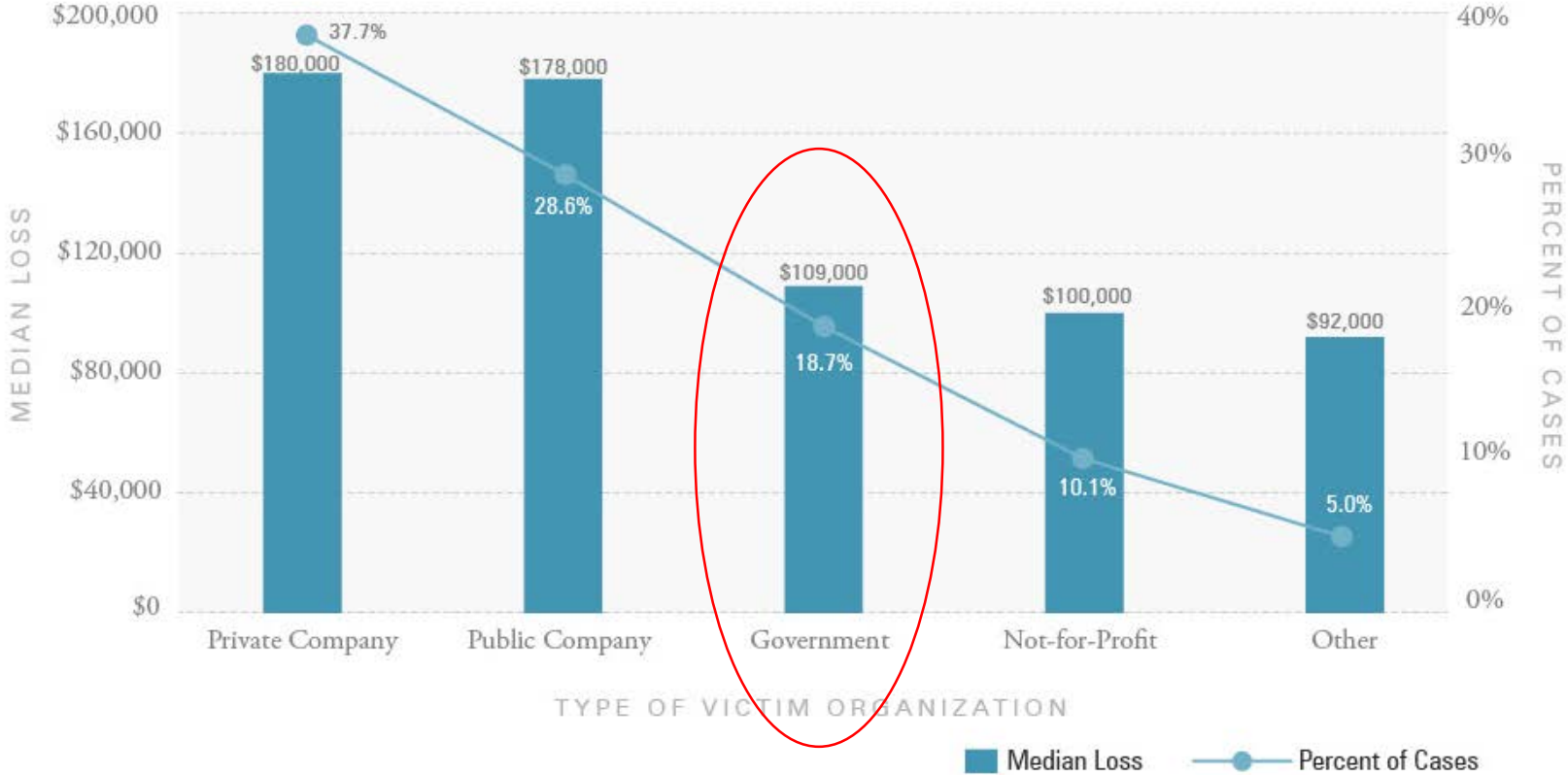
**Figure 67:** Frequency and Median Loss Based on Position of Perpetrator—United States



Source: 2016 Association of Certified Fraud Examiner *Report to the Nations on Occupational Fraud*

# Types of Victim Organization

Figure 38: Type of Victim Organization—Frequency and Median Loss



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# Investigation Overview

- Considerations
  - Communication / Privileged issues
  - Project scope
  - Reporting
  - Timing
- Assemble the team
  - Forensic Accountants
  - City Representative
  - City Attorney
  - Other experts if necessary
- The role of the investigation team
  - Develop the investigation scope and process
  - Conduct the investigation
  - Report to the City Council or City Attorney
  - Manage the constituencies – the independent auditors and other government agencies (e.g. District Attorneys and State & Federal Agencies)





# Investigation Approach – Basic Steps

- Obtain an understanding of the critical issues
  - Understand underlying issues and organizational environment to develop an approach to investigate and resolve issues
- Compile and develop an inventory of key documents
  - Organize, manage, and identify documents to assist with resolving the matter(s) quickly
  - Utilize technology to search and recover digital data (e.g. email, hard drive, general directories, and voice mails, etc.)
  - Assist with document discovery requests
- Assist in interviews of key company personnel
  - Identify and interview key personnel that often times provide valuable discoveries on the issues
- Review of accounting documents
  - Review various types of documentation such as financial statements, underlying supporting ledgers, and source documentation

# Investigation Approach – Basic Steps (Continued)

- Analyze significant accounting transactions and account balances
  - Systematic review of accounting system(s) and internal controls to identify potential areas of weakness
  - Analyses and testing for the existence of unusual or irregular transactions
- Estimate or determine financial impact
  - Quantify impact of financial losses (i.e. embezzlement amount)
- Communicate our findings
  - Oral vs. written



# Recovery of Fraud Losses – Insurance Considerations

- What insurance covers embezzlement or theft or addresses the financial risks of fraud and embezzlement by an insider?
  - Recover losses via a commercial crime insurance policy – Insurance that addresses the risk of insider theft is referred to by various names:
    - Fidelity bond
    - Crime coverage
    - Employee dishonesty coverage
  - Many public sector organizations purchase this coverage as part of a package policy that addresses other property exposure. It is also possible to obtain the coverage as a standalone policy
  - Take steps to ensure your organization has adequate insurance coverage before a loss occurs



# Protect Your Organization

- Set the right tone and create the proper environment
- Enhance and communicate a reporting mechanism
- Perform fraud risk assessments
- Develop clear, written policies and procedures
- Provide regular training
- Develop a robust internal audit function
  - Segregation of duties, proper documentation and audit trail, appropriate authorization and approvals, review of reconciliation process, whistleblower policy and hotline, and rotation of personnel, etc.
- Develop a heightened awareness of lifestyle, morale, attitude changes





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## **Contact Us**

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