

5th Annual Fraud Busters Conference

Office of the State Auditor
Fraud in North Carolina State Government



NC OSA
The Taxpayers' Watchdog

1

Introduction

Speaker Bio -

Kevin Thomas, CFE

North Carolina Office of the State Auditor- Special Investigations Supervisor

Kevin is a supervisor in the Special Investigations division of the North Carolina Office of the State Auditor (OSA) and has 14 years of auditing, accounting, and investigative experience. As a supervisor in the Special Investigations division, Kevin investigates allegations of fraud, waste, and abuse of public funds in state and local government.

Kevin is also the lead investigator in OSA's digital forensics lab where he is responsible for acquiring and analyzing hard drive images and email correspondence as part of the investigation process.

Kevin is a Certified Fraud Examiner and received a Bachelor's Degree in Accounting from North Carolina State University and a Master's Degree in Business Administration from Campbell University.

NC OSA
The Taxpayers' Watchdog

2

Presentation Outline

- Fraud 101 Exam - Fun with Fraud
- Fraud in State and Local Government (highlight of cases in 2019)
- Waste and Abuse in State and Local Government
- COVID-19 Recovery Act
- Recap and Questions



3

Fraud 101 Exam - Fun with Fraud

Q1

Q1. What gender typically commits the majority of fraud?

- A. Male
- B. Female



4

Fraud 101 Exam - Fun with Fraud

A1

What gender typically commits the majority of fraud?

A. Male

Males committed 72% of all occupational fraud and are also responsible for larger losses than their female counterparts.

However.....

In United States and Canada, these percentages are much closer male (59%) and female (41%)

NCOSA
The Taxpayers' Watchdog

Source: 2020 Report to the Nations. Copyright 2020 by Association of Certified Fraud Examiners, Inc. (pg. 5 & 43)

5

Fraud 101 Exam - Fun with Fraud

Q2

Q2. What is the most common form of occupational fraud?

- A. Asset Misappropriation
- B. Financial Statement Fraud
- C. Corruption (e.g. schemes involving bribery or conflicts of interest)

NCOSA
The Taxpayers' Watchdog

6

Fraud 101 Exam - Fun with Fraud

A2

What is the most common form of occupational fraud?

A. Asset Misappropriation (86%)

Ironically, the median loss associated with asset misappropriation fraud is the lowest, \$100,000 while corruption (43%) and financial statement fraud (10%) have median losses of \$200,000 and \$954,000.



Source: 2020 Report to the Nations. Copyright 2020 by Association of Certified Fraud Examiners, Inc. (pg. 10)

7

Fraud 101 Exam - Fun with Fraud

Q3

Q3. What method contributes the most to the detection of occupational fraud?

- A. IT Controls
- B. External Audit
- C. Internal Audit
- D. Tip
- E. Management Review



8

Fraud 101 Exam - Fun with Fraud

A3

What method contributes the most to the detection of occupational fraud?

D. Tip (43%)



Source: 2020 Report to the Nations. Copyright 2020 by Association of Certified Fraud Examiners, Inc. (pg. 19)

9

Fraud 101 Exam - Fun with Fraud

Q4

Q4. What source is the biggest contributor of tips?

- A. Concerned Citizens
- B. Vendors
- C. Competitors
- D. Employees
- E. Anonymous



10

Fraud 101 Exam - Fun with Fraud

A4

What source is the biggest contributor of tips?

D. Employees (50%)



Source: 2020 Report to the Nations. Copyright 2020 by Association of Certified Fraud Examiners, Inc. (pg. 19)

11

Fraud 101 Exam - Fun with Fraud

Q5

Q5. In 2020, what submission method was responsible (percentage) for submitting the most tips?

- A. Web-based / Online forms
- B. Telephone Hotline
- C. Email
- D. Letter
- E. B and C



12

Fraud 101 Exam - Fun with Fraud

A5

In 2020, what submission method was responsible (percentage) for submitting the most tips?

E. B and C

In 2020, Telephone Hotline (33%) and Email (33%) were tied. While Web-based / Online forms were responsible for 32%.



Source: 2020 Report to the Nations. Copyright 2020 by Association of Certified Fraud Examiners, Inc. (pg. 22)

13

Fraud 101 Exam - Fun with Fraud

Q6

Q6. What type of organization is victimized the most (# of cases) by occupational fraud?

- A. Government
- B. Public Company
- C. Private Company
- D. Non-profit



14

Fraud 101 Exam - Fun with Fraud

A6

What type of organization is victimized the most (# of cases) by occupational fraud?

C. Private Company (44%)

Government accounted for 16% of the cases of occupational fraud.



Source: 2020 Report to the Nations. Copyright 2020 by Association of Certified Fraud Examiners, Inc. (pg. 24)

15

Fraud 101 Exam - Fun with Fraud

Q7

Q7. What is the median loss for occupational fraud in Government and Public administration?

- A. \$476,000
- B. \$99,999
- C. \$100,000
- D. \$250,000
- E. \$101,000



16

Fraud 101 Exam - Fun with Fraud

A7

What is the median loss for occupational fraud in Government and Public administration?

C. \$100,000



Source: 2020 Report to the Nations. Copyright 2020 by Association of Certified Fraud Examiners, Inc. (pg. 27)

17

Fraud 101 Exam - Fun with Fraud

Q8

Q8. What is the primary control weakness that contributes to occupational fraud?

- A. Overriding Existing Internal Controls
- B. Lack of Internal Controls
- C. Poor Tone at the Top
- D. Lack of Management Review
- E. Incompetent Employees



18

Fraud 101 Exam - Fun with Fraud

A8

What is the primary control weakness that contributes to occupational fraud?

B. Lack of Internal Controls



Source: 2020 Report to the Nations. Copyright 2020 by Association of Certified Fraud Examiners, Inc. (pg. 36)

19

Fraud 101 Exam - Fun with Fraud

Test Results

What your score indicates...

8 - You are the next Sherlock Holmes

6-7 - You are Dr. John H. Watson (*a very capable fraud buster*)

4-5 - You are Irene Adler (*One of only a handful of people who beat Sherlock in a battle of wits*)

1-3 - You are Professor Moriarty (*your co-workers should keep an eye on you at all times*)



20

Fraud 101 Exam - Fun with Fraud

Polling Question #1



21

Fighting Fraud

Why was our Fraud 101 Exam important?

It highlighted the following ways to prevent and detect fraud:

- Internal Controls
- Hotlines
 - The different intake methods for receiving allegations
 - Hotline utilization - where are the tips coming from so we can ensure our hotline information is shared and marketed to the appropriate areas
- Knowledge / Information
 - To accurately complete risk assessments
 - To make the decisions within our organizations and properly assign the limited resources we have at our disposal



22

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 1

Case #1 - Kickback at the Coast

Finding: *Town Commissioner derived a direct benefit of \$12,500 from a contract related to a dredging project.*

Overview:

- Town leased land that was used as a transfer site during a dredging project for \$50,000
- Former Town Mayor (and friend of the Commissioner) negotiated the cost of the lease agreement on behalf of the land owner(s)
- The negotiated agreement resulted in the former Town Mayor receiving \$25,000 for overseeing the use of the land while the land owner(s) received \$25,000 for the use of their land
- On December 21, 2017, the former Mayor received \$25,000 directly from the Town for overseeing the use of the land
- On December 22, 2017, the Town Commissioner received a “gift” of \$12,500 from the former Mayor. This represents 25% of the \$50,000 that was paid to lease the land



Source: <https://www.auditor.nc.gov/EPWeb/reports/investigative/inv-2019-0481.pdf>

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 1

A Red Flag Missed by the Finance Officer...

The image displays three invoices from the same vendor, dated December 19, 2017. Each invoice is for \$25,000.00. The first invoice lists a 'Dredging Project' for \$25,000.00. The second and third invoices list a 'Dredging Project' for \$12,500.00. The invoices are otherwise identical in their header information, including the date, invoice number, and vendor details.



Source: <https://www.auditor.nc.gov/EPWeb/reports/investigative/inv-2019-0481.pdf>

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 1

Invoices processed without adequate documentation

The Finance Officer told investigators she processed the invoices because:

- She had worked with the former Mayor
- The \$50,000 expenditure matched the approved budget amendment despite the fact that all three invoices were identical
- An environmental consulting firm approved the \$50,000 expenditure “based on the understanding that the \$50,000.00 cost... was accounted for in the project budget as approved by the state”

Other red flags missed by the Finance Officer...

- No Written Contract for the lease of the land
- The Commissioner signed as “agent” on both vendor applications for the land owner(s)



Source: <https://www.auditor.nc.gov/EPWeb/reports/investigative/inv-2019-0481.pdf>

25

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 1

Interview Quotes:

- The \$12,500 payment to the Commissioner was a “Gift”
- “Let me be clear, that money was all given to me, and I am allowed to spend my money in any way I see fit and for whatever reason I see fit”
- “is not public knowledge.... because people would start connecting it to [the Commissioner] got paid for some of this dredging project”



Source: <https://www.auditor.nc.gov/EPWeb/reports/investigative/inv-2019-0481.pdf>

26

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 1



NC OSA
 The Taxpayers' Watchdog

27

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 2

Case #2 - Excessive Auto Parts

Finding: *Town improperly billed at least \$210,035 for parts*

Overview: The Town contracted with a local parts vendor to provide parts and supplies for its Fleet Management operations

The Town paid for:

- \$130,810 for parts that did not fit Town fleet vehicles
- \$75,923 for parts that may fit Town vehicles, but did not match the associated work orders
- \$2,147 in core deposit charges
- \$1,155 for duplicate invoices

NC OSA
 The Taxpayers' Watchdog

Source: <https://www.auditor.nc.gov/EPSWeb/reports/investigative/INV-2019-0321.pdf>

28

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 2

A parts vendor employee:

- Submitted additional invoices for parts that were not listed on the work order
- Added parts to the invoice that were not on the work order
- Created duplicate invoices for the same work order

The Town failed to detect the improper billings, due to:

- The parts vendor did not provide adequate parts detail reporting
- Town’s Fleet Manager did not sufficiently review the invoices
- Town’s work order system did not interface with the parts vendor’s invoice system



Source: <https://www.auditor.nc.gov/EPSSWeb/reports/investigative/INV-2019-0321.pdf>

29

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 3

Example 1

Case #3 - Local Government Officials Enjoy Fine Dining

Finding: Failure to comply with travel policy resulted in \$1,575 in unallowed travel expenses

Overview: City Manager and Council members enjoyed lavish meals while at conferences that were paid for with public funds

Interview Quote :

“I am not to be held to any city policy or practice that restricts my food choices, the number of times I chose to eat, or the cost of my meals while on official business and/or travel for the city”



Source: <https://www.auditor.nc.gov/EPSSWeb/reports/investigative/INV-2020-0558.pdf>

30

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 3

Example 1

Taking a closer look at the meals provided with public funds...

Per Diem Amounts:

Breakfast \$8.00

Lunch \$11.00

Supper \$21.00

The Capital Grille			
Quantity	Description of Meals	Individual Price	Total Price
Main Course			
3	Porcini Bone-In Ribeye	\$ 54.00	\$ 162.00
3	Scallops with Mushroom Risotto	\$ 44.00	\$ 132.00
1	Bone-In Ribeye Steak	\$ 52.00	\$ 52.00
1	Citrus Glazed Salmon	\$ 37.00	\$ 37.00
1	Roasted Chicken	\$ 29.00	\$ 29.00
Desserts			
1	Cheesecake	10.00	10.00
1	Coconut Cream Pie	10.00	10.00
1	Apple Crostata	11.00	11.00
1	Homemade Sorbet	10.00	10.00
Miscellaneous Items			
2	Calamari	16.00	32.00
2	Lobster & Crab Cakes	20.00	40.00
1	Lobster Mac 'N Cheese	18.00	18.00
1	Sautéed Spinach	11.00	11.00
2	Creamed Spinach	11.00	22.00
3	Asparagus	11.00	33.00
1	Wedge Salad	12.00	12.00
1	Brussels Sprouts Salad	12.00	12.00
2	Field Greens Salad	11.00	22.00
1	Pellegrino Large	7.00	7.00

Brasilia Churrasco Steakhouse			
Quantity	Description of Meals	Individual Price	Total Price
Main Course			
10	Dinner	\$ 37.95	\$ 379.50
Desserts			
3	Key Lime Pie	\$ 8.00	\$ 24.00
2	NY Cheesecake	\$ 8.00	\$ 16.00

City Manager Meals			
Date	Restaurant	Description of Meals	Price
8/22/2018	The Lobster Trap	Lobstah & Turf	\$ 55.00
11/14/2018	The Lobster Trap	Lobstah & Turf	\$ 55.00
		Bibb Salad	\$ 9.00
2/26/2019	King's Crab Shack and Oyster Bar	Steam Bucket	\$ 31.99
		App Special	\$ 11.99



Source: <https://www.auditor.nc.gov/EPSWeb/reports/investigative/INV-2020-0558.pdf>

31

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 3

Example 2

Case #3 Cont. - Council Member Accumulates \$47,704 in Uncollected Utility Bills

Finding: Multiple City officials prevented the Business Services Center from attempting to collect \$47,704 in utility bills owed by a City Council Member

Overview: As far back as 2003, City officials intervened to prevent disconnection of the Council Member’s utilities

Due to the preferential treatment, the Council Member was able to accrue excessive utility account balances

In total, the Finance Director wrote off \$47,704 in outstanding utility bills for this Council Member



Source: <https://www.auditor.nc.gov/EPSWeb/reports/investigative/INV-2020-0558.pdf>

32

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 3

Example 2

A recurring and concerning trend

- In 2013, \$11,096 was written off which covered utility usage at the Council Member’s property from 1999 to 2010
- In 2017, \$36,608 was written off which covered utility usage at the Council Member’s property from 1999 to 2013
- As of January 29, 2020 the Council Member’s overdue account balance was \$2,989 (balance that exceeded 60 days)



Source: <https://www.auditor.nc.gov/EPWeb/reports/investigative/INV-2020-0558.pdf>

33

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 3

Example 2

Policy Regarding Delinquent Utility Accounts

- Any bill for any other class of service not paid within twenty-one days of the billing date is considered delinquent
- Previous balances must be paid within seven days of the billing date or service will be discontinued

What happened to the Internal Controls?

- A former City Manager told the Finance Director, “Ask the Business office to not call [Council Member] about his utilities. If there is an issue either go through you or me”
- There was a deviation from the established process due to preferential treatment



Source: <https://www.auditor.nc.gov/EPWeb/reports/investigative/INV-2020-0558.pdf>

34

Fraud in State and Local Government

“The OSA Hotline in Action”

Case 3

Example 2

Polling Question #2



Source: <https://www.auditor.nc.gov/EPWeb/reports/investigative/INV-2020-0558.pdf>

35

Waste and Abuse in State and Local Government

“Performance Audit”

State Agency Overspent on Salary Adjustments

Finding: Failure to comply with state laws results in overspending of \$39 million on salary adjustments

Overview:

- 2018-2019 salary adjustments were not in accordance with Section 34.19 of Session Law 2018-5
- Total amount of salary adjustments exceeded the two-percent-of-payroll-expense limit
- Employees did not relinquish claims to longevity and career status as required by state law



Source: <https://www.auditor.nc.gov/EPWeb/reports/performance/PER-2019-4200.pdf>

36

COVID-19 / CARES ACT

“An Opportunity for Fraud”

An Opportunity for Fraud

\$6 billion disbursed to hundreds of entities including state and local governments, non-profit and private organizations.

Factors that Contribute to Increased Opportunities

- Time Sensitive (Rate at which the Funds need to be disbursed)
- Funding Structure / Disbursement Method (Not all funds are reimbursement based)
- Amount / Volume of Funds being Disbursed
- Number of Recipients receiving CARE Act funds

The Fraud Triangle



NC OSA
The Taxpayers' Watchdog

37

COVID-19 / CARES ACT

“An Opportunity for Fraud”

Office of the State Auditor - A three-step approach

Step I - Preliminary Financial Audit

- Were the funds disbursed or delegated correctly

Step II - A Series of Performance Audits

- Did the agencies establish a plan (policies) to ensure the funds were spent correctly
- Evaluate the outcome, was the objective achieved and were the funds used efficiently

Step III - Ongoing Monitoring / Audits

- Additional monitoring and compliance through the single audit efforts of our Financial Audit division

NC OSA
The Taxpayers' Watchdog

38

Recap

“The importance of Fraud Busters”

Our role in safeguarding public funds and detecting fraud

- Develop the necessary internal controls and monitoring activities
- Consider and evaluate the current climate and opportunities for fraud, waste, and abuse
- Seek out information and knowledge that allows us to make informed decisions for Risk Assessments and Investigative Planning
- Provide North Carolina citizens and state employees with methods to report fraud, waste, and abuse



39

Recap

“Office of the State Auditor and our commitment to North Carolina”



Report Fraud, Waste, and Abuse

1(800)730-TIPS (8477)
HotTips@ncauditor.net

State Auditor's Hotline
 2 South Salisbury Street
 20601 Mail Service Center
 Raleigh, NC 27699-0600

<https://www.auditor.nc.gov/HotTips/>



40

Recap

“Office of the State Auditor and our commitment to North Carolina”

Polling Question #3



41

Questions

“Fraud in North Carolina State Government”

Thank you!!

Questions



Kevin Thomas, *Special Investigations Supervisor*
Email: kevin.Thomas@ncauditor.net
Phone: (919)807-7658



42