

Why are we issuing this alert?

Nonpayroll disbursement frauds related to billing schemes, check tampering, false expense reimbursements, and illicit register disbursements account for 62 percent of occupational fraud schemes in the United States and Canada.¹ Similarly, during the last 5 years we have identified public money losses in Arizona governments totaling over \$4 million due to these types of disbursement fraud schemes. The longer a fraud remains undetected, the greater the financial losses. This alert outlines how certain disbursement frauds occurred and what actions management can take to deter and detect them.

Billing schemes are the most common form of asset misappropriation and generally involve payments for unauthorized personal purposes or for fictitious goods and services. Employees responsible for issuing checks can perpetrate billing schemes when inadequate oversight allows the opportunity. For example, in all the situations described below, opportunity was created when for years, no one performed an independent reconciliation of the entity's records to bank records or otherwise evaluated payment propriety:

"Billing schemes are the most common form of asset misappropriation and also cause a high median loss, making this type of fraud a particularly significant risk."
-2020 ACFE Report to the Nations

- For just over 7 years, a fire district administrative manager unlawfully issued 474 district checks totaling nearly \$1.8 million to herself, her father, her then-fiancé, and to personal credit card accounts associated with those same individuals.²
- For nearly 5.5 years, a water district accounting manager embezzled \$524,686 of district monies when she issued 32 district checks to herself and 3 businesses for which she managed the bank accounts. She had also failed to disclose these businesses on district conflict-of-interest forms.³
- For 6.5 years, a water district office administrator/governing board clerk used district monies totaling \$278,371 for personal purposes. She issued unauthorized district warrants payable to herself, her family members, and her creditors, and paid for personal purchases made on district credit accounts.⁴

Check tampering involves intercepting, forging, or altering a check drawn on an employer's bank account. Tampered checks are made payable to the perpetrator, an accomplice, fake vendors, or simply "cash." Similar to billing schemes, employees responsible for issuing checks may commit check tampering when internal controls are inadequate. In the example that follows, the perpetrator was able to alter district warrants (checks) undetected because no one compared cleared warrants to district records.

- For 5 years, a vocational education district business manager tampered with 29 district warrants totaling \$73,091, making them payable to herself and her credit card company. As shown in the figure to the right, the business manager (Deborah Long) often handwrote her name on the face of a

¹ See Association of Certified Fraud Examiners, Inc., *Report to the Nations on Occupational Fraud and Abuse*, 2020.

² See Office of the Auditor General, *Show Low Fire District—Theft and Misuse of Public Monies*, May 2016, Report 16-402.

³ See Office of the Auditor General, *Pine-Strawberry Water Improvement District—Theft and Misuse of Public Monies*, October 2017, Report 17-405.

⁴ See Office of the Auditor General, *Thunderbird Irrigation Water Deliver District of Pinal County No. 2—Criminal Indictment—Theft and Misuse of Public Monies*, April 2019, Report 19-403.

warrant as an additional payee and deposited it into her personal bank account.⁵

False expense reimbursements are when fraudsters submit for reimbursement of expenses that are fictitious or deceptive in nature because they are intentionally mischaracterized, overstated, or duplicative. One area of particular risk is employee travel-related expenses, in which the perpetrator falsely inflates mileage totals or conceals a purchase of unapproved items like alcohol by mischaracterizing the purchase as an allowable item and failing to provide an itemized receipt. In the example below, the employee was a high-ranking public official with little to no oversight.

- Over a 7-month period, a county justice courts administrator submitted 5 fraudulent travel reimbursements for expenses totaling \$1,296 that he did not pay for. Rather, the County had already paid for them because the administrator charged them to the County's purchasing card. No one reviewed the administrator's purchasing card transactions or otherwise compared them to his travel reimbursements.⁶

Illicit register disbursements are schemes in which an employee makes false entries on a cash register to conceal the fraudulent removal of cash. In the example below, the perpetrator was able to conceal her scheme because she controlled the recording, depositing, and reconciling of cash receipts without an independent, thorough review.

- For 4 years, a high school bookstore manager embezzled \$120,708 of bookstore receipts by manipulating the District's cash register 374 times. She tendered sales as normal then retroactively created false negative transactions causing the receipting system to show intakes of \$0.00 instead of the actual amount received. She stole the money, reconciled the false register reports to deposit records, and submitted that reconciliation to the District where only a cursory review was performed.⁷

Recommendations

Public officials should exercise their fiduciary responsibilities to protect public monies by establishing and enforcing sound disbursement fraud deterrence and detection measures, such as:

- **Segregation of duties**—Separate accounting procedures among 3 employees so that authorization, recording, and custody functions are performed by different employees. For example, the employee preparing and recording checks should not maintain check stock and should not be an authorized signer. Additionally, the employee reconciling disbursements to bank records should not prepare or sign checks and the reconciliation should include an examination of each canceled check to ensure propriety. Likewise, employees involved in collecting cash should not be responsible for totaling sales from the receipt processing system. An employee independent of cash collection responsibilities should total sales from the system and another employee should reconcile those sales to cash collections.
- **Proper supporting documentation**—Prior to authorizing a payment transaction, employees should ensure supporting documentation is sufficient and appropriate. Employees should ensure no duplicate payments were made through other means such as a purchasing card or credit card and be aware of conflict-of-interest disclosures that may reveal inappropriate payments.
- **Conflict-of-interest forms**—Establish and enforce a written policy to ensure all applicable employees complete and sign conflict-of-interest forms at least every year, indicating "none" if no such conflict exists. If an employee has a conflict, the employee must not participate in any way related to the conflict.

⁵ See Office of the Auditor General, *Western Arizona Vocational Education District—Criminal Indictment—Theft and Misuse of Public Monies*, August 2018, Report 18-402.

⁶ See Office of the Auditor General, *Maricopa County Justice Courts Administration—Criminal Indictment—Theft and Misuse of Public Monies*, February 2019, Report 19-401.

⁷ See Office of the Auditor General, *Tolleson Union High School District—Theft and Misuse of Public Monies*, December 2015, Report 15-406.