

Northern Arizona University

Theft and Misuse of Public Monies

Special Investigation

October 2016
Report 16-405



A Report to the Arizona Legislature

Debra K. Davenport
Auditor General





The Auditor General is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits and special reviews of school districts, state agencies, and the programs they administer.

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Audit Staff

Lindsey Perry, Manager and Contact Person

Contact Information

Arizona Office of the Auditor General

2910 N. 44th St.

Ste. 410

Phoenix, AZ 85018

(602) 553-0333

www.azauditor.gov



DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

MELANIE M. CHESNEY
DEPUTY AUDITOR GENERAL

October 24, 2016

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

The Arizona Board of Regents

Rita Cheng, President
Northern Arizona University

The Honorable David W. Rozema, Coconino County Attorney

The Office of the Auditor General (Office) has conducted a special investigation of Northern Arizona University (University) for the period July 1997 through January 2013. The Office performed the investigation to determine the amount of public monies misused, if any, during that period and the extent to which those monies were misused.

The investigation consisted primarily of inquiries and examination of selected financial records and other documentation. Therefore, the investigation was substantially less in scope than an audit conducted in accordance with generally accepted auditing standards. Accordingly, the Office does not express an opinion on the adequacy of the University's financial records or internal controls. The Office also does not ensure that all matters involving the University's internal controls, which might be material weaknesses under standards established by the American Institute of Certified Public Accountants or other conditions that may require correction or improvement, have been disclosed.

The Special Investigative Report describes the Office's findings and recommendations as a result of this special investigation.

Sincerely,

Debbie Davenport
Auditor General

Attachment



Northern Arizona University **Theft and Misuse of Public Monies**

CONCLUSION: As part of its responsibility to prevent and detect fraud, Northern Arizona University (University) management took appropriate action by reporting a fraud allegation to both its police department and the Office of the Auditor General (Office). The university police department subsequently requested our Office to investigate the allegations of financial misconduct by Edwin Talley, former university postal services manager, and we determined that from July 1997 through January 2013, Mr. Talley used fraud schemes to embezzle public monies totaling \$354,902. The embezzled monies came from university revenues that consisted primarily of state appropriations and students' tuition and fee payments, and should have been used to pay for services provided to university students. We have submitted our report to the Coconino County Attorney's Office, which has taken criminal action against Mr. Talley resulting in his indictment on six felony counts.

Mr. Talley embezzled \$354,902 of university monies by orchestrating two fictitious vendor schemes

During this 15½-year period, Mr. Talley may have violated state laws related to theft, misuse of public monies, fraudulent schemes, and money laundering when he caused the University to issue 245 checks and make 12 purchasing card payments totaling \$354,902 to two fictitious vendors he created. The majority of these checks were fraudulently endorsed and deposited in a credit union account he jointly held with another person, and monies were generally withdrawn or transferred to one of Mr. Talley's separately held bank and credit union accounts within a few weeks. The purchasing card payments were directly credited to another of Mr. Talley's bank accounts. All of the embezzled monies were commingled with other monies and spent by Mr. Talley for his personal purposes. To orchestrate and help conceal his schemes, Mr. Talley falsified information in the University's accounting software, submitted fictitious invoices, and fabricated purchasing card records.

Investigation highlights

Former Northern Arizona University postal services manager Edwin Talley:

- Embezzled \$345,902 by paying himself through fictitious vendors.
- Falsified computer data and purchasing card records, and submitted fictitious invoices in order to conceal his embezzlement.

Former university officials failed to safeguard and control university monies

Mr. Talley embezzled this money by abusing his authority as university postal services manager, a position he held for over 36 years. He also took advantage of former university officials' poor oversight of his activities. In particular, management did not monitor or take steps to ensure employees were appropriately following policies and procedures designed to protect public monies. Accordingly, management was unaware that employees falsely verified the receipt of postal supplies never received and improperly shared their accounting software login credentials. Additionally, management did not adequately train employees to investigate invoice anomalies or reconcile purchasing card reports to bank software, either of which actions could have revealed Mr. Talley's fraud scheme.

Although the University took corrective measures, university officials can take additional actions to improve control over public monies and help deter and detect fraud

With the 2012 implementation of new accounting software, university officials improved certain internal controls which, when combined with a university-wide review of purchasing card activity, led to their discovery of Mr. Talley's fraud schemes. In addition, in the time since the Office's investigation began, management reported that they implemented other improvements to controls over university monies such as adding purchasing card software that disallows purchasing card users from manipulating activity statements. Management also implemented a new conduct, ethics, reporting, and transparency program, which outlines employees' legal and ethical obligations to the University. Finally, management also conducted an employee training regarding internal controls and financial transactions, and mandated that employees not share their login credentials.

Recommendations

Although the University took corrective measures and no internal control system can completely prevent dishonest behavior such as Mr. Talley's, the following recommendations are additional actions university officials can take to improve control over public monies and help deter and detect fraud. Specifically, university officials should:

- Perform periodic reviews on a random and unannounced basis to ensure that invoiced goods marked as received in the accounting software are actually physically located and accounted for.
- Continue to require employees to sign statements acknowledging their understanding and acceptance of university policies concerning employment. Additionally, consider requiring all employees to separately acknowledge their understanding and acceptance of the university policy that prohibits the sharing of login credentials and outlines employees' responsibilities for protecting and locking their computer or work stations when not in use.
- Periodically assess whether controls over the University's purchasing process are functioning effectively and as designed, and continue to provide training to those employees responsible for making and authorizing purchases. Likewise, ensure that the University continues providing training to employees involved in the purchasing process. That training should include guidance on how to review vendor invoices for accuracy and appropriateness, as well as for anomalies that should be investigated. Additionally, university officials should consider including criteria in these employees' performance evaluations regarding their adherence to university purchasing procedures.



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INTRODUCTION AND BACKGROUND

Northern Arizona University (University), located in Flagstaff, is one of three fully accredited public universities governed by the Arizona Board of Regents. During fiscal year 2015, the University received revenues of nearly \$524 million to provide educational services to nearly 28,000 students. The university postal services department oversees the entire university mail operation, including distributing incoming and outgoing mail according to local, state, and federal laws, and coordinates with external postal agencies for mail delivery.

In addition to his university employment, Mr. Talley operated Talley Security, an online personal security business

Mr. Talley had postal services responsibilities for over 36 years beginning in August 1976 and ending with his termination in January 2013. During his tenure Mr. Talley supervised about six employees and managed all university postal and shipping services, including purchasing supplies and preparing annual postal services budgets. Since at least 1999, Mr. Talley was assigned a university purchasing card for business purposes such as postal supplies and travel-related expenditures.

Mr. Talley had university postal services responsibilities for over 36 years.

Starting in 1998 and continuing throughout his employment with the University, Mr. Talley operated an online business called Talley Security, sometimes also using derivatives of the same name such as Talley Personal Security Products or Talley Auto Alarms and Security. He sold various items such as stun guns, mace/repellent spray, security systems, cameras, and safety lights. In addition to check and money orders, he later accepted credit card payments, which were processed through a merchant services company and deposited in his business bank account.¹

Mr. Talley's other purported companies, Flag Mailing Products and Omega Supplies, existed in name only

As described on pages 3 and 4, the University paid Flag Mailing Products and Omega Supplies \$354,902 for postal supplies, the majority of which was deposited to Mr. Talley's credit union or business bank accounts. Aside from receiving monies from the University, Flag Mailing Products and Omega Supplies existed in name only. In fact, neither Flag Mailing Products nor Omega Supplies had a real business address or phone number, or even a web presence in which actual goods such as postal supplies were offered for sale. Additionally, neither company was registered with the Arizona Corporation Commission or Arizona Secretary of State, and neither had a Flagstaff business license to collect sales tax.

University officials discovered payments associated with Talley Security

In November 2012, Mr. Talley prepared a conflict-of-interest form disclosing his business ownership of Talley Security to the University. University officials were also aware of his business association through their general

¹ Although no university payments to Talley Security were noted during our investigation, as described on pages 4 and 5, Mr. Talley used his Talley Security merchant services company and business bank account to process university purchasing card payments to his fictitious company, Omega Supplies.

knowledge. As a result, during a university-wide review of purchasing card activity in January 2013, a university employee discovered \$12,287 of charges made with Mr. Talley's university purchasing card in a 6-month period that were associated with his Talley Security business. In particular, she conducted research, and in addition to other discrepancies she determined that while the charges and associated payments were made to a company named Omega Supplies, the listed phone number matched the Talley Security phone number. Consequently, university officials conducted an inquiry, determined that Mr. Talley had violated several university policies, contacted university police and our Office, and terminated Mr. Talley's employment.

A university employee determined that \$12,287 of Mr. Talley's purchasing card charges were associated with his business, Talley Security.

Mr. Talley made several admissions and paid \$12,287 to the University

Mr. Talley made several admissions to university officials during their inquiry of his misconduct, although he did not concede that the two vendors he paid himself through were fictitious companies.² Specifically, he apologized for his actions, accepted responsibility for misusing the purchasing card to make \$12,287 charges to Omega Supplies, and said he made a bad decision. Later, he admitted to university officials that there were other university payments made to one of his companies called Flag Mailing Products and he had deposited these checks to his credit union account.

On January 23, 2013, the University withheld \$4,668 from his final paycheck, which included his accumulated vacation pay. A week later, Mr. Talley repaid the remaining portion of Omega Supplies charges through a \$7,619 cashier's check payable to the University.

Mr. Talley admitted to university officials that he:

- Misused the university purchasing card by paying \$12,287 to his company Omega Supplies.
- Deposited to his credit union account university check payments issued to another of his companies, Flag Mailing Products.

² Mr. Talley declined to interview with Auditor General staff.



Mr. Talley embezzled \$354,902 of university monies by orchestrating two fictitious vendor schemes

From July 1997 through January 2013, Mr. Talley, former Northern Arizona University (University) postal services manager, embezzled \$354,902 of public monies when he orchestrated two fictitious vendor schemes and falsified purchasing card records to help conceal his embezzlement. The embezzled monies came from university revenues that consisted primarily of state appropriations and students' tuition and fee payments, and should have been used to pay for services provided to university students. As shown in Table 1 below, for over 15 years Mr. Talley caused the University to issue 245 checks and make 12 purchasing card payments to his fictitious companies, Flag Mailing Products and Omega Supplies, respectively. Neither of these companies had a real business address or even a web presence in which actual goods such as postal supplies were offered for sale. To help orchestrate and conceal his schemes, Mr. Talley falsified information in the University's accounting software, submitted fictitious invoices, and fabricated university purchasing card records.

Table 1
Public monies Mr. Talley embezzled
July 1997 through January 2013

| Description | Number of payments | Amount |
|---|--------------------|------------------|
| Check payments to fictitious vendor, Flag Mailing Products | 245 | \$342,615 |
| Purchasing card payments to fictitious vendor, Omega Supplies | 12 | 12,287 |
| Total embezzled | 257 | \$354,902 |

Source: Auditor General staff analysis of university and bank records, and interviews with university representatives.

Mr. Talley caused the University to issue 245 checks to his fictitious company, Flag Mailing Products

From July 1997 through May 2012, Mr. Talley caused the University to issue 245 checks totaling \$342,615 to his fictitious company, Flag Mailing Products, for postal supplies the University never requested nor received. Specifically, although certain records were not available for the entire embezzlement period, Mr. Talley's university accounting software login credentials, or those he had access to, were used to authorize the majority of the supposed purchase of goods from Flag Mailing Products.³ In addition, the receipt of these goods was falsely marked as verified in the accounting software mostly by these same users' credentials. The remaining purchase authorizations and receipt of goods verifications were made by other employees who admitted to Auditor General staff that although they should have inspected the goods, they never physically verified any items were actually

³ As further described in Finding 2 on page 7, one of Mr. Talley's subordinates shared with him her university accounting software login credentials.

received. Additionally, many of the invoiced items were for extraneous products, such as wooden nesting bins that were not used by postal services or for mailbox doors and locks that were donated by another organization.

Likewise, 29 Flag Mailing Products' invoices for these supposed items were fabricated to match the false purchase information in the accounting software.⁴ Still, these invoices included certain anomalies that university employees should have noticed and investigated. For instance, invoices often had math and spelling errors, were missing amounts and dates, and were missing invoice numbers or had invoice numbers that were contrived from the date. Invoices were generally submitted to the finance department one to three times a month and ranged from \$444.62 to \$2,472.57. As a result, the University issued 245 checks totaling \$342,615 payable to Flag Mailing Products. Although records are not available for all 245 checks, 179 of these checks were sent to either Mr. Talley's personal residence or to a mailbox he rented from a retail postal services store.

Although not all checks were available and some endorsements were illegible, 216 of the 245 checks payable to Flag Mailing Products were fraudulently endorsed with the name of Mr. Talley's friend. This false endorsement was sometimes combined with "Flag Mailing Products" and then deposited into a credit union account that Mr. Talley and his friend held jointly. Although Mr. Talley declined to interview with Auditor General staff, he provided through his attorney a sworn statement declaring that this friend ". . . had no involvement whatsoever in any misconduct involving Northern Arizona University (NAU) funds." Similarly, Mr. Talley's friend reported to Auditor General staff that she had never heard of Flag Mailing Products and did not deposit or endorse any of these checks. Within a few weeks after the checks were deposited, the monies were generally withdrawn or transferred to Mr. Talley's other bank and credit union accounts and used for his personal expenses.

Flag Mailing Products fictitious invoices often:

- Contained math and spelling errors.
- Were missing amounts and dates.
- Were missing invoice numbers or had invoice numbers that were contrived from the date.

Mr. Talley caused the University to make 12 purchasing card payments to his fictitious company, Omega Supplies

From July 2012 through January 2013, Mr. Talley caused the University to make 12 purchasing card payments totaling \$12,287 to his fictitious company, Omega Supplies, for postal supplies the University never requested nor received and falsified purchasing card records to help conceal his embezzlement. Specifically, after the University implemented new accounting software in July 2012 and required all vendors to provide a new W-9 form—*Request for Taxpayer Identification Number and Certification*, Mr. Talley ceased submitting Flag Mailing Products invoices and began using his university purchasing card to purportedly buy supplies from a different fictitious company, Omega Supplies. These university purchasing card payments were processed through the same merchant services company Mr. Talley used for his legitimate business of selling personal security devices described on page 1, Talley Security, and deposited in his business bank account.

The 12 university purchasing card payments were processed electronically and deposited in Mr. Talley's business bank account—To obtain these university purchasing card payments electronically, Mr. Talley accessed the credit card processing service he used for Talley Security. Specifically, the University's purchasing card information was processed through the merchant service company's remote terminal, which Mr. Talley ordered in Omega Supplies' name and linked to his business bank account. After charging the university purchasing card, payments were directly credited to Mr. Talley's business bank account generally within 4 days, commingled with other deposits, and used for his personal and business expenses.

⁴ Flag Mailing Products' invoices submitted prior to July 2007 were not available.

Mr. Talley submitted fictitious Omega Supplies' invoices and fabricated purchasing card records to help orchestrate and conceal his scheme—

Although Mr. Talley typically charged these fictitious Omega Supplies' purchases ranging from \$670 to \$1,104 twice a month, he did not always submit an invoice to the finance department. The eight invoices he did submit were fictitious and had anomalies similar to Flag Mailing Products invoices. For instance, they often had math errors, used nonexistent addresses, always had even dollar amounts, were missing amounts, and had invoice numbers that were contrived from the date. Additionally, the invoiced items were mostly for extraneous products, such as mailbox locks, which another organization donated.

Mr. Talley did not submit any invoices for the remaining four Omega Supplies charges. Rather, Mr. Talley fabricated records by removing these amounts from the bank purchasing-card-activity statements and omitting the same charges from his purchasing-card logs, which he submitted monthly to a university finance department employee for approval. Nevertheless, Mr. Talley was not able to fully conceal his theft by this omission as he did not alter the bank software, which recorded all 12 of the Omega Supplies' purchasing card charges. Consequently, as described on page 1, university staff were able to find all \$12,287 of Mr. Talley's purchasing card charges that he made with Omega Supplies.

Omega Supplies fictitious invoices often:

- Contained math errors.
- Used nonexistent addresses.
- Always had even dollar amounts.
- Were missing amounts.
- Had invoice numbers that were contrived from the date.



Former university officials failed to safeguard and control university monies

Former Northern Arizona University (University) officials failed to properly protect and control university monies by not always providing adequate oversight of the postal services department, thus affording Mr. Talley the opportunity to abuse his position and circumvent controls. Specifically, university officials failed to ensure policies and procedures designed to safeguard public monies were being appropriately abided by, as follows:

- **Receipt of postal supplies not verified**—Although university policy required an employee independent of ordering postal supplies to inspect the goods and verify the actual receipt of them prior to any payment, none of the reported postal supplies from Flag Mailing Products were ever verified as having been physically received. Two employees whose login credentials showed that they had verified the receipt of these supplies admitted to Auditor General staff that they had not physically verified that any of the items were in fact received. A third employee was unaware that her credentials were used to verify the receipt of these items in the accounting software and denied that she approved these purchases, but admitted she had shared her login credentials with her supervisor, Mr. Talley.
- **Accounting software login credentials improperly shared**—As described above, one of Mr. Talley's subordinates improperly shared her login credentials with him, thus allowing him access and ability to override existing controls within the accounting software. Moreover, it came to our attention that several other employees were also improperly sharing their login credentials despite university policy prohibiting such action.
- **Invoice anomalies not investigated**—All available invoices from Flag Mailing Products and Omega Supplies contained at least one anomaly, and most of these invoices included several more unusual aspects that an employee should have investigated. Although an employee independent of ordering postal supplies reviewed invoices and compared them to information recorded in the accounting software prior to payment, the reviewer failed to notice and pursue unusual aspects such as math and spelling errors, missing amounts and dates, even dollar amounts, and missing or nonsequential invoice numbers. A further study would have also revealed nonexistent addresses and could have stopped Mr. Talley's fraud scheme.
- **Purchasing card reports not reconciled to bank software**—Mr. Talley's supervisors reviewed only the purchasing card logs and activity statements he submitted to them and did not reconcile or compare these reports to the bank software. This reconciliation would have revealed the Omega Supplies charges Mr. Talley had omitted from his reports and could have stopped his fraud scheme.



Although the University took corrective measures, university officials can take additional actions to improve control over public monies and help deter and detect fraud

In the time since the Office of the Auditor General's investigation began, university officials reported that they instituted new procedures and implemented improvements to controls over university purchasing practices such as adding new purchasing card software that disallows purchasing card users from manipulating activity statements. University officials also implemented a new conduct, ethics, reporting, and transparency program that outlines employees' legal and ethical obligations to the University. Finally, university officials conducted a training for employees regarding internal controls and financial transactions, and mandated that employees not share their login credentials.

Recommendations

Although the University took these corrective measures and no internal control system can completely prevent dishonest behavior such as Mr. Talley's, the following recommendations are additional actions university officials can take to improve control over public monies and help deter and detect fraud. Specifically, university officials should:

1. Perform periodic reviews on a random and unannounced basis to ensure that invoiced goods marked as received in the accounting software are actually physically located and accounted for.
2. Continue to require employees to sign statements acknowledging their understanding and acceptance of university policies concerning employment. Additionally, consider requiring all employees to separately acknowledge their understanding and acceptance of the university policy that prohibits the sharing of login credentials and outlines employees' responsibilities for protecting and locking their computer or work stations when not in use.
3. Periodically assess whether controls over the University's purchasing process are functioning effectively as designed and explore ways to strengthen them. Likewise, ensure that the University continues providing training to employees involved in the purchasing process. That training should include guidance on how to review vendor invoices for accuracy and appropriateness, as well as for anomalies that should be investigated. Additionally, university officials should consider including criteria in these employees' performance evaluations regarding their adherence to university purchasing procedures.



CONCLUSION

On October 20, 2016, the Coconino County Attorney's Office presented evidence to the Coconino County Grand Jury. This action resulted in Mr. Talley's indictment on six felony counts related to theft, misuse of public monies, fraudulent schemes, and money laundering.

