Why are we issuing this alert?

From 2013 through 2023, we issued 40 financial investigation reports that included charges of fraudulent schemes associated with about $5 million of Arizona public money losses. This alert outlines the difference between the 2 fraudulent schemes classifications pursuant to Arizona law, how certain instances of these fraudulent schemes occurred, and what actions management can take to deter and detect them.

What *are* fraudulent schemes?

Arizona law defines 2 classifications of fraudulent schemes: (1) fraudulent schemes and artifices (a class 2 felony) and (2) fraudulent schemes and practices; willful concealment (a class 5 felony).[1]

In the first classification–artifices–a fraudster devises a deliberately deceptive plan either to gain something of value or to deprive another of honest services. The fraudster relies on manipulation, deceitfulness, or misrepresentation. A key component of this statute is that the fraudster knowingly obtains a benefit. Significantly, though the fraudster always relies on deception, a guilty finding under Arizona law does not require anyone else to rely on the fraudster's deception.

In the second classification–practices–a guilty finding does not require that the fraudster receives a benefit. It does require willful concealment, so much so, it is in the name of the statute. Concealment may include knowingly falsifying or covering up material facts or knowingly making or using false or fictitious documents. Notably, this statute applies only to schemes related to public agency business.

Not surprisingly, the 2 classifications of fraudulent schemes may, and often do, transpire together. Below, we illustrate each of these fraud scenarios.

Top 5 concealment methods used by fraudsters

41%	Created fraudulent physical documents
37%	Altered physical documents
31%	Created fraudulent electronic documents or files
28%	Altered electronic documents or files
23%	Destroyed or withheld physical documents

Source: Association of Certified Fraud Examiners, Inc., *Occupational Fraud 2024: A Report to the Nations.*

Fraudulent schemes and artifices—Prior to her termination after only 6 months of employment, a school district budget accounting specialist deceitfully removed 14 blank checks from the district's check stock. One month after her termination, 3 of these checks payable to herself totaling $5,000 were deposited in her personal account. These 3 checks listed an authorized signer's forged signature, and 1 included a false memo section purpose of "stipend" that the specialist was not authorized to receive. She was unable to negotiate the remaining 11 checks because the district initiated stop payment actions. Significantly, during the specialist's training, the district discovered financial misconduct by her predecessor and took prompt action, but their actions were not enough to prevent the specialist from implementing a similar fraudulent scheme. Specifically, they removed the specialist's access to blank check stock but failed to ensure all checks were numerically accounted for. As a result, they failed to detect that she had already removed blank checks.[2]

Fraudulent schemes and practices—Over the course of 2 months, a county education service agency (agency) finance administrator created 4 false invoices totaling $19,473, falsified a reimbursement request form, and submitted this fraudulent documentation to the Arizona Governor's Office of Education Innovation (Governor's Office) in order to obtain agency reimbursement from the State of Arizona's American Recovery and Reinvestment

[1] Arizona Revised Statutes §§13-2310 and 13-2311.

[2] See Arizona Auditor General, *Wilson Elementary School District—Criminal Indictment—Theft, Fraudulent Schemes, Forgery, and Misuse of Public Monies*, Report 22-402.

Act—State Fiscal Stabilization Fund. Although she obtained no benefit herself, the administrator devised this scheme after previously seeking and being denied a $19,473 grant reimbursement from the Governor's Office for expenditures deemed unallowable. The administrator was able to implement her schemes because the agency did not maintain effective internal controls over federal award programs and allowed the administrator to prepare, approve, and submit reimbursement requests without any independent review.[3]

Artifices and practices—For 4.5 years, a university manager of information technology used his university purchase card (p-card) to make 810 personal purchases totaling $124,093. He obtained this benefit by (1) using his p-card instead of the procurement process on the pretext of providing immediate support to senior leadership and (2) making his p-card purchases without prior approval. He concealed his scheme by submitting vague business purposes and forged p-card receipts 2-3 months late, making it falsely appear as if the purchases were for valid university purposes. The manager was able to implement his schemes because, in spite of the university having appropriate p-card policies and procedures, management allowed him to bypass them in the name of supporting senior leadership.[4]

Why did this happen?

It is critical that entities create written policies and procedures that clearly communicate (1) what each policy is about, (2) the procedures for day-to-day operations, including step-by-step instructions for routine tasks, (3) allowed conduct, (4) prohibited conduct, (5) reporting requirements, and (6) signed attestations of understanding. However, without policy enforcement–as seen in each of the 3 examples above–expectations may be forgotten, ignored, or opportunistically circumvented by a scheming fraudster.

Recommendations

- Employ physical safeguards to support policy. For example, as in the previous school district example, using a numerical check log form to control check issuance could prevent or help detect check stock theft.
- Separate duties. For example, as in the previous agency example, a secondary review of grant reimbursement requests could identify unsupported or unallowable expenditures. If an entity is too small to separate duties, require an independent review of work being done.
- Lead by example (set the tone at the top). For example, as in the previous university example, requiring all purchases, including those for leadership, to follow required policy processes could more quickly identify and prevent inappropriate/unallowable expenditures.

Further, beyond creating and enforcing clear policies and procedures, entities can implement specific anti-fraud controls that may reduce fraud loss and duration. To that end, we recommend government entities:

- Require accounting and payroll employees to take vacations during which time another employee performs key functions to deter and detect hidden and potentially fraudulent activities by the primary position holder.
- Create an environment, including a whistleblower system, in which employees feel confident in reporting potential misconduct without fear of retribution.
- Conduct unannounced reviews of existing internal control procedures to enforce and verify adherence to established policies and procedures.

> **"Preventing fraud from occurring in the first place is the most cost-effective way to limit fraud losses."**
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> ***- 2024 ACFE Report to the Nations***

[3] See Arizona Auditor General, *Yavapai County Education Service Agency—Criminal Indictment—Misuse of Public Monies*, October 2013.

[4] See Arizona Auditor General, *Arizona State University—Criminal Indictment—Theft, Misuse of Public Monies, Fraudulent Schemes, and Forgery*, Report 23-406.