



Thomas P. DiNapoli
State Comptroller

OFFICE OF THE STATE COMPTROLLER

DIVISION OF
LOCAL GOVERNMENT AND SCHOOL ACCOUNTABILITY



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Preventing Fraud and Abuse of Public Funds: Local Governments Need to Do Better

According to the Association of Certified Fraud Examiners (ACFE), U.S. organizations lose an estimated 7 percent of annual revenues to fraud. Based on the projected U.S. Gross Domestic Product for 2008, this percentage indicates a staggering estimate of losses of approximately \$994 billion among organizations.

The audits conducted by the Office of the State Comptroller (OSC) are designed to examine for fraud or abuse in the activities that are the subject of the audit. Whether we are reviewing cash collections, elevator inspections, or special education programs in school districts, we consider how fraud or abuse may occur and conduct tests to determine whether it has actually occurred. Our audits are designed to provide reasonable, but not absolute, assurance that we would identify such inappropriate activity, if it has actually occurred. As such, the State Comptroller serves as the taxpayers' watchdog, providing assurance that public funds are not being misused.

Recent Audits

Unfortunately, our audits have found that, much like corporate entities, local governments and school districts are not immune to fraud or abuse. From 2007 to the present day, our local government auditors from the Division of Local Government and School Accountability (LGSA) have uncovered instances of fraud or abuse totaling approximately \$10 million in 51 municipalities and school districts. When auditors uncover fraud, they not only prevent further misuse of taxpayer dollars, they provide an opportunity for the local government to recover what has been lost. Also, the audits deter others from future inappropriate activity. Examples of fraud or abuse identified include:

- **Town of Fairfield, \$378,000:** The town's former supervisor and his wife received \$378,000 to which they were not entitled. The former supervisor's signature stamp was used to sign 316 of 347 unauthorized checks. In April 2010, the former supervisor's wife was indicted on 350 counts related to theft of these town funds.
- **Town of Sodus, \$50,000:** The former town clerk admitted to embezzling more than \$50,000 in town funds during the past eight years. She stole cash from the town's safe at night and created fake deposit tickets to hide the losses. When collecting taxes, she took some of the cash payments and paid tax stubs and used the interest and penalties paid by others to cover the amounts taken.

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- **Town of Islip, \$12,250:** The clerk did not safeguard undeposited cash, secure blank checks, or cash receipt books. As a result, a cash shortage of at least \$12,250 occurred and was not detected.
 - **Bolivar Fire District, \$119,429:** The treasurer diverted \$85,861 in moneys received on behalf of the district into bank accounts held by him, disbursed \$26,868 in moneys from district accounts for unauthorized purposes, and paid himself stipends totaling \$6,700, which exceeded the amount of compensation approved by the board of fire commissioners. We referred this matter to law enforcement for investigation.
 - **Town of Alden, \$12,400:** The town clerk did not record all fees collected, resulting in a shortage of approximately \$12,400. She subsequently pled guilty to tampering with public records, resigned her position, and repaid funds owed to the town.
 - **Town of Ticonderoga, \$100,000:** The highway superintendent, who purchased \$100,000 of overpriced and unnecessary highway supplies, admitted to accepting \$2,000 in gift-card kickbacks from the vendor who sold him \$84,000 of those supplies. In September 2009, the highway superintendent was charged with felony official misconduct.
 - **Hopevale Union Free School District, \$108,650:** The district's former business manager misappropriated \$108,650 by issuing himself unauthorized checks, improperly increasing his own salary, and using district funds to pay for his personal tax liability. The district also inappropriately paid certain salaries, retirement incentives and other benefits totaling \$55,200 to a former principal and two teachers.
 - **Ithaca Housing Authority, \$206,834:** The former executive director misappropriated \$45,000 and incurred questionable expenditures of more than \$160,000. This situation occurred because the executive director could override the authority's internal control system and process payments outside the normal flow of most transactions. The authority board had abdicated its oversight role and essentially did not monitor the authority's financial operations.
 - **Rome City School District, \$9,500:** The district's director of facilities and a former school grounds supervisor used district moneys to pay for equipment that was purchased for private use. Auditors identified approximately \$9,500 in stolen property. Both individuals were incarcerated and ordered to pay restitution.

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- **Caledonia–Mumford Central School District, \$7,154:** During our initial meeting with district management, district officials told us that the former central treasurer stole \$4,000 in extra-classroom activity funds. Further testing by auditors identified additional bookstore thefts and other unaccounted-for funds totaling \$3,154 that occurred during our audit.
 - **Village of Port Henry, \$152,864:** The clerk-treasurer admitted to the town board that she stole approximately \$4,000 in garbage sticker receipts. However, our auditors determined that cash in the amount of at least \$152,864 was unaccounted for over a five-year period. The clerk-treasurer used various schemes to remove cash from the village office while avoiding detection by other village officials, including skimming, lapping, substituting checks for cash, and adjusting receivable accounts.
 - **Town of Colonie, \$100,000:** Town officials chose to dump excess soil at a private club, incurring costs of about \$48,000 – which was as much as \$42,000 more than the costs of alternate options. The additional work the town performed at the site (including grading, parking lot enlargement, and resurfacing), valued at about \$20,000, benefited the club rather than the town. The town also incurred additional unnecessary costs of \$38,000 for roadway material.
 - **Mount Vernon City School District, \$1,087:** The district’s purchasing agent used a district gasoline credit card without authorization for charges totaling \$1,087 for his personal use. This matter was referred to law enforcement for further investigation.
 - **Town of Genesee Town Justice, \$11,147:** The town justice deposited court fines and fees into her personal checking account, which resulted in a cash shortage of \$11,147. After audit fieldwork was completed, the town justice was arraigned on one count of grand larceny in the third degree, one count of falsifying business records, and one count of official misconduct.
 - **Village of Arkport, \$44,500:** The village paid three employees a total of \$43,000 in unauthorized leave payments, and village officials and their family members failed to reimburse the village for cell phone charges totaling \$1,500.
 - **Montgomery County, \$4,400:** The county paid more than \$4,400 for questionable transportation claims billed by a taxi company owned by a county employee, in violation of the county’s code of ethics. We referred these matters to local law enforcement for investigation.

Ongoing Audits

LGSA's accountability audits ensure that control systems are in place to safeguard the assets of local governments. These audits reveal how the lack of adequate controls can lead to criminal abuse of local government assets. LGSA has 16 additional audits nearing completion that have fraud findings totaling possibly \$400,000, which are expected to be issued by December 2010. For example:

- A treasurer wrote unauthorized checks totaling approximately \$250,000 to a business that he owned.
- In 10 municipalities revenues from the sale of scrap metal is missing.
- An employee operates a private law practice out of his public offices. He also employed three other public employees in the law practice, and all four individuals use public equipment while working for the private law firm.
- A town justice has a cash shortage of at least \$37,699.
- A treasurer misappropriated at least \$74,000 of village funds.
- A town provided more than \$12,000 of unauthorized or enhanced health insurance benefits and almost \$7,000 of unsupported lump sum payments to employees and retirees.

When completed, these reports will be referred to local law enforcement for investigation.

Local Officials Need to be Alert

According to ACFE's *2008 Report to the Nation on Occupational Fraud and Abuse*, 46 percent of frauds were detected through tips and only 23 percent through internal controls that were in place. We need to do better. Local officials need to be more vigilant and improve their internal controls to prevent fraud and abuse from occurring and to detect it if it does. Simple things, like properly separating duties so that no one employee handles an entire transaction from start to finish, or providing oversight of financial activity by supervisors and Board members, doing a thorough and accurate audit of all claims, doing the periodic audits required by law, and requiring that adequate books and records be maintained and presented for periodic inspection, could go a long way toward preventing fiscal malfeasance.

Local officials also must be alert to situations that may be indicative of a problem. They must be able to identify “red flags for fraud” – that is, a set of circumstances that are unusual in nature, or vary from the normal activity – and be able to use them as signals that something may be out of the ordinary and needs to be investigated further.

Following are some common examples of red flags that local officials can use to identify fraud:

Employee Red Flags

- Employee lifestyle or behavioral change
- Significant personal debt and credit problems
- Refusal to take vacation or sick leave
- Lack of segregation of duties in vulnerable areas.

Management Red Flags

- Reluctance to provide information to auditors
- Management decisions are dominated by an individual or small group
- Weak internal control environment
- Excessive number of checking accounts or frequent changes in banking accounts
- Excessive number of year-end transactions
- High employee turnover rate
- Service contracts result in no product.

Records and Reports Flags

- Large number of write-offs of accounts
- Discrepancies between bank deposits and postings
- Excessive or unjustified cash entries and/or adjustments
- No supporting documentation for adjusting entries
- Incomplete or untimely bank reconciliations.

Cash Receipts and Disbursements Flags

- Lack of segregation of key duties
- Deposits not made intact
- Cash receipts issued out of sequence
- No cash receipt log kept
- Lack of control over CFO’s signature
- Uncontrolled access to blank checks.

Purchasing Flags

- Lack of segregation of key duties
- Purchases that bypass normal procedures
- Changes made to vendor files
- Vendor addresses match employee addresses
- Copies of invoices used to pay vendors.

Fixed Asset Flags

- Lack of segregation of key duties
- Lack of asset tags and periodic physical inventories
- Lack of physical security over assets.

After local officials identify a red flag, they must take action to determine its effect on their organization. Evaluating the red flag may be accomplished by financial analysis, observation, or by any other technique that tests an apparent weakness. When officials complete their fraud analysis, they must take steps to correct the situation.

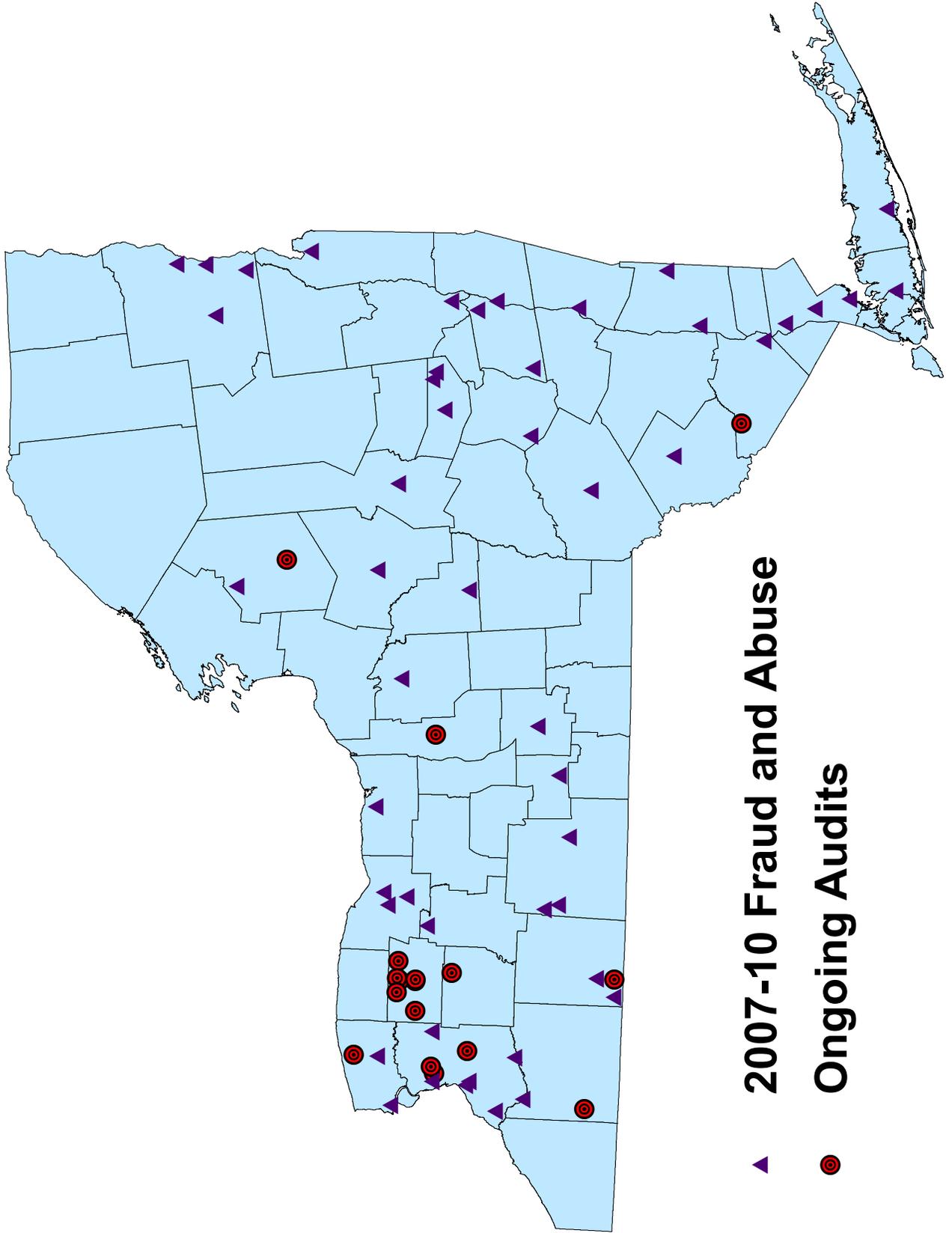
LGSA offers training on these fraud indicators and the appropriate internal controls for various financial operations. These training classes are available at major local government association conferences and are offered on a regional basis to interested parties.

Summary

Comptroller DiNapoli has made a concerted effort to test for and root out fraud wherever it occurs. Unfortunately fraud and abuse knows no barriers; they are not restricted to a geographic location of the state, or to a type or particular size of government. OSC has identified fraud or abuse in all types of local governments in every part of the state. Fraud and abuse have other effects besides the amount of money that is lost and unavailable for productive uses by government. They also have the corrosive effect of undermining the public's trust and confidence in government.

OSC audits can be a useful tool in identifying and stopping ongoing fraud and abuse, but the Comptroller's Office has limited resources and New York is a big state. Well-designed internal controls, education to bring greater awareness to the issue, and constant vigilance by local officials who are on site every day are necessary components to safeguard the public's money and provide assurance to all New Yorkers that their funds are being used only for legitimate purposes.

Combating a State of Fraud and Abuse



▲ 2007-10 Fraud and Abuse

● Ongoing Audits



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Office of the State Comptroller**

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For additional copies of this report contact:

**New York State Office of the State Comptroller
Division of Local Government and School Accountability**
110 State Street, 12th floor
Albany, New York 12236
(518) 474-6975

**Email address: localgov@osc.state.ny.us
www.osc.state.ny.us**