

HIGHER EDUCATION COMPLIANCE CONFERENCE: 2018

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A COLLUSION CASE STUDY ON EMBEZZLEMENT, TRAVEL FRAUD, AND MISAPPROPRIATION AT THE UNIVERSITY

**How Collusion Evaded Detection and Rendered the
Control Environment Ineffective for Six Years**



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Disclaimers: Some Ideas to Keep in Mind

- ✓Information summarized in the presentation includes published research, documents, articles, interviews, and recollections.
- ✓The presenter is not an auditor, accountant, or attorney. The presenter is a scientist.
- ✓The presenter would like to acknowledge the many professionals who worked on this case, including: university internal auditors, investigators, campus police, and federal agents.
- ✓Events in this presentation are factual. Some names of those involved have been changed.
- ✓Viewpoints expressed in this presentation do not necessarily represent the official position of the University of California.

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Outline

- 1 -- What is collusion?**
Secret agreement
- 2 -- Collusion case study**
Fraud at the university
- 3 -- Red flags of collusion**
Behavioral indicators
- 4 -- Stopping collusion**
Creating an ethical culture



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Part 1: What is Collusion?



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Definition

A secret agreement or cooperation between two or more individuals for a dishonest, deceitful, or illegal purpose



SECRET

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Definition

Collusion is a course of coordinated conduct between two or more individuals that's adverse to someone else's interest or benefit



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Research on Collusion*

- Collusion is a coordinated effort where employees work together
- Hard to detect so fraud continues for years
- Colluders are able to circumvent anti-fraud controls
- Increasing controls do not deter/stop collusion
- Loyalty, group culture, and distrust of others cement social bond
- Pools group resources to construct a sophisticated fraud
- Offenders choose to collude, although intimidation may have been used to recruit



* Free, C and PR Murphy. "The Ties that Bind: The Decision to Co-Offend in Fraud." *Contemporary Accounting Research* 32(1):18-54, Spring 2015.

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Research on Collusion*

Collusive shared goals:

- “We are helping the organization”
- “No one was hurt”
- “No big deal - everyone does it”
- “The government is cheating us”
- “No one’s paying attention to the controls”
- “There’s widespread corruption in our organization”



* Free, C and PR Murphy. “The Ties that Bind: The Decision to Co-Offend in Fraud.” *Contemporary Accounting Research* 32(1):18-54, Spring 2015.



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Collusion: Sophistication of Crime*

“In major accounting frauds, it is unlikely that any one individual has the resources, access, and capacity to construct a sophisticated fraud without the assistance of others.”

“The body of research powerfully suggests that an important key to understanding criminal behavior *lies in the social nature of crime* and that by focusing on individual characteristics of offenders provides only a partial view of fraud.”



* Free, C and PR Murphy. “The Ties that Bind: The Decision to Co-Offend in Fraud.” *Contemporary Accounting Research* 32(1):18-54, Spring 2015.
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What Does Collusion Look Like?



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Part 2 University Case Study



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Background: University Career

- ✓ Faculty (33 year academic)
- ✓ Scientist in the field of nutrition
- ✓ Director (statewide program)
- ✓ Federal funding (\$14 million annual budget)



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Discovery



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Budget Error

- ✓\$60K project budget
- ✓Increased to \$210K
- ✓\$150K error?
- ✓Handwritten note



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ALARM!

Internal alarm leads to action

- Check the office files
- Files were locked
- Where's the key?



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Red File Folder Contains Evidence



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Purchase Order in Red File

Numerous Red Flags

- ❖ Inappropriate approval
- ❖ No separation of duties
- ❖ Vague description (Canon Optura 600)
- ❖ Expensive (\$1400)
- ❖ Vender (Fry's Electronics)
- ❖ Handwritten note ("Pick Up")



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Moral Dilemma

What is my responsibility?

- As the director?
- As an employee?
- To the university?
- To the government?
- To the department chair?
- To the accused?



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Reporting Misconduct at the University

*Policy dictates to report to supervisor
But what should one do if their supervisor is involved?*



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Ask Questions



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Chair's Response to Wrongdoing

- ☐ “No big deal”
- ☐ “Everyone does it”
- ☐ “You’re out of step”
- ☐ “People are complaining about you”
- ☐ “I thought she was your friend”



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Result

Silence: Nothing happens!

And the evidence?



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What happens to the evidence?

Deposited into the Chair's Personal Vault!



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Is this Enough?

- ✓ Employee appears contrite and works hard
- ✓ Employee is monitored and follows procedures
- ✓ Employee takes responsibility for judgment error
- ✓ Employee pays back the \$1400



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A Tip from Co-Worker



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Travel Fraud!

- ✓ Accused took 254 fraudulent trips
- ✓ \$22,672 in-state trips
- ✓ \$2,278 out-of-state trips
- ✓ Approval signals collusion



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Whistleblower Report

Misuse of government property
Embezzlement
Travel fraud



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Part 3

Red Flags of Collusion



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Not Reporting Criminal Activity

Collusion Red Flag

- ✓ **Misuse not taken seriously**
- ✓ **Refusal to report upward**
- ✓ **Protecting the accused**
- ✓ **Reporter threatened: Keep quiet or else!**
- ✓ **Disposition of evidence: Hide it!**
- ✓ **Action taken? None**



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Stalling Tactics Collusion Red Flag

- Discovery: February 28
- Report to Chair: March 2
- Letter of Warning 1: April 7
- Letter of Warning 2: June 12
- WB Report: August 25
- Dean's Allegation: September 1



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Failure to Act Collusion Red Flag

- ✓ Failure: HR did not put employee on investigatory leave
- ✓ Failure: Evidence not secured
- ✓ Failure: Computer not secured
- ✓ Failure: No communication with compliance professionals

Failure to act after fraud report



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Retaliatory Attempts to Silence the Truth*

Collusion Red Flag

- Office ransacked
- Car vandalized
- Smear campaign using a petition
- Car tire tampering



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* Source: AB Joy, **Retaliation**, CreateSpace, 2013.

Internal Auditing: Investigation Begins*



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*Source: AB Joy, **Whistleblower**, Bay Tree Publishing, 2010.

Collusion Evidence Uncovered

- Chair approved employee's fake trips
- Employee approved costly purchases for chair
- Employee approved payroll transfer for chair's employees
- Chair and employee's secret meetings behind closed doors



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Retaliation By Higher-Ups “Push the whistleblower out of the organization”

- Shoved in hall by higher-up
- False allegations by higher-up



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Involvement of Higher-Ups

If fraud was conducted by one subordinate employee working alone – there would be no reason NOT to take appropriate action.

Collusion is suspected when higher-ups are involved!



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Fraud Findings: \$2.3 Million Returned to Government

- Embezzlement of \$160,000 substantiated
- Travel fraud of \$25,000 substantiated
- Fraudster pleads guilty (2008)
- Fraudster serves time in prison (2009)
- Misappropriation by chair (\$150,000)*
- Undocumented time claim by chair (\$400,000)
- Undocumented time claims from others (\$1.544 million)



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** \$150K for 'chair' on budget spreadsheet*

Six Years of Fraud

January 2002: Backlog of university payment by agency

February 2002: Employee fixes invoice backlog

February 2002: Embezzlement begins (\$1018 camera)

August 2003: Program passes agency audit

September 2003: Employee begins travel fraud*

January 2004: Chair begins misappropriation

February 2006: Embezzlement discovery (\$1400)

August 2006: Travel fraud discovery (\$20,000 estimated)

August 25, 2006: Director blows the whistle



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** What's a good time to commit fraud? Following an audit!*

Collusion Culture

Reactions by Colleagues: "The scandal is hurting me!"

Toward the Whistleblower

Reason

- | | |
|-----------------|-----------------------------|
| ➤ Rage | ⇒ To create fear |
| ➤ Spread gossip | ⇒ To reduce credibility |
| ➤ Shun | ⇒ To keep in the dark |
| ➤ Isolate | ⇒ To promote silence |
| ➤ Intimidate | ⇒ To stop the whistleblower |



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Collusion Culture

Reactions of Colleagues: “I need job security!”

Toward the Wrongdoers

Reason

- | | |
|----------------------|----------------------------------|
| ➤ Fear | ⇒ Getting caught |
| ➤ Secret discussions | ⇒ Defense strategies |
| ➤ Encircle | ⇒ There’s credibility in numbers |
| ➤ Support | ⇒ To silence the whistleblower |



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Collusion Culture

Reactions of Higher-Ups: “No one will notice the missing money!”

Toward the Whistleblower

Reason

- | | |
|---------------------|-----------------------------------|
| ➤ Threats | ⇒ To intimidate the whistleblower |
| ➤ Taint reputation | ⇒ To cover-up their involvement |
| ➤ No action taken | ⇒ To stall and deny |
| ➤ False allegations | ⇒ To make whistleblower leave |



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Control Environment Findings by Campus Auditors

- ❑ Control environment circumvented
- ❑ Separation of duties ineffective
- ❑ Collusion between chair and employee



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Collusion Findings -- Campus Auditors

- Chair failed to establish internal control system
- Chair created a negative environment to exclude director
- Chair made “expensive purchases” without the director’s approval
- Chair consistently excluded director from reviewing purchases



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Disregard for the Rules

Collusion Red Flag

- \$80K in research for chair paid with funds that prohibited research
- \$150K in expensive equipment for chair purchased without government approval
- \$400K falsely charged in time reporting of chair
- Poor attitude toward government, rules, regulations
- Chair approved 254 “fake” travel vouchers

These actions were contrary to the federal regulations



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Attitude of Entitlement

Collusion Red Flag

- The “end” justifies the “means”: “For the greater good”
- Too good to pass up: “No one was paying attention”
- Victimless crime: “No one was hurt”
- Evens the playing field: “The organization is corrupt”

Colluders rationalize their actions



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excuses
Excuses
excuses
Excuses

Result of Collusion: Six Years of Fraud

- Oversight: No control environment to monitor financial transactions
- Signature authority: Authorization wasn't monitored
- Inventory control: Missing documentation, poor record-keeping
- Accounting: Copies of transactions corrected and Xeroxed
- Payroll: End-of-year Transfers of salary and benefits for chair's staff
- Travel: Copies of travel were missing from office files

These failures allowed fraud to continue for six years



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Part 4

Creating an Ethical Culture



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Society benefits from reporting misconduct

- ✓ High cost of undetected fraud
- ✓ Tips are a significant source of detection
- ✓ Unethical behavior is common



Source: AB Joy. "Is whistleblowing effective for an organization?" *Compliance & Ethics Professional* 8(6):20, December 2011.

Strong Ethical Culture

- Improves trust
- Improves employee morale
- Increases willingness to report
- Reduces misconduct



Slide by Amy Block Joy
Source: Ethics Resource Center: 2009 Business Ethics Survey.

Improve Institution Integrity by Preventing Retaliation

- ✓Retaliation is a predictable outcome
- ✓Retaliation is a second form of misconduct
- ✓Retaliation is costly (resources and investigation time)
- ✓Ethics education improves employee morale



Source: AB Joy, "The high cost of whistleblower retaliation: Why institutions should prevent it." *Compliance & Ethics Professional* 10(4):37, August 2013.

Remember

Collusion erodes the ethical culture of an institution



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Thank You!

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