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



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.
- $\checkmark \mbox{Viewpoints expressed in this presentation do not necessarily represent the official position of the University of California.}$

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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

Part 1: What is Collusion?

A secret agreement or cooperation between two or more individuals for a dishonest, deceitful, or illegal purpose Silv. The Plant by Universe Author of Lecensed under CC BYNC SA

Definition

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





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 201:

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.



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.

What Does Collusion Look Like?

CORRUPTION

What Does Collusion Look Like?

Part 2 University Case Study



Background: University Career

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





Discovery

Oream/bime...

Budget Error

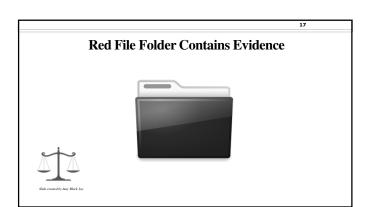
*\$60K project budget
*Increased to \$210K
*\$150K error?
*Handwritten note

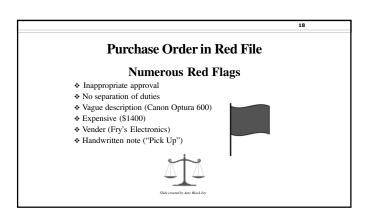
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ALARM!

Internal alarm leads to action

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



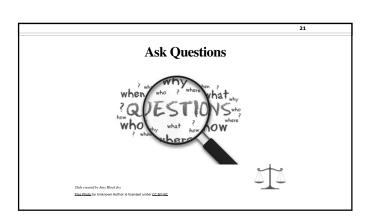


Moral Dilemma What is my responsibility?

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



Reporting Misconduct at the University Policy dictates to report to supervisor But what should one do if their supervisor is involved?



Chair's Response to Wrongdoing

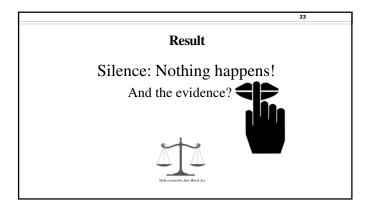
"No big deal"

"Everyone does it"

"You're out of step"

"People are complaining about you"

"I thought she was your friend"



What happens to the evidence?
Deposited into the Chair's Personal Vault!

Is this Enough?

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





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A Tip from Co-Worker





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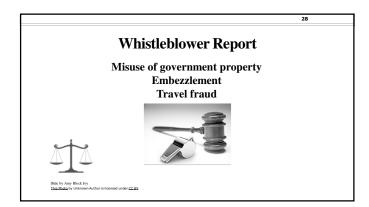
Travel Fraud!

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





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Part 3
Red Flags of Collusion

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

Stalling Tactics Collusion Red Flag Discovery: February 28 • Report to Chair: March 2 origin from Ger fraud /fro:d/ tended to result or thing inten • Letter of Warning 1: April 7 • Letter of Warning 2: June 12 WB Report: August 25 • Dean's Allegation: September 1

> Failure to Act **Collusion Red Flag**

 \checkmark 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





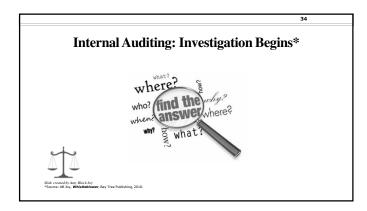
Retaliatory Attempts to Silence the Truth* **Collusion Red Flag**

Petition!

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







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





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!





Fraud Findings: \$2.3 Million Returned to Government

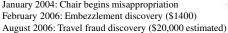
- Embezzlement of \$160,000 substantiated
- Travel fraud of \$25,000 substantiated
- Fraudster pleads guilty (2008)
- Fraudster serves time in prison (2009)
- •Misappropriation by chair (\$150,000)*
- Undocumented time claim by chair (\$400,000)
- Undocumented time claims from others (\$1.544 million)



* \$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



August 25, 2006: Director blows the whistle



* 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

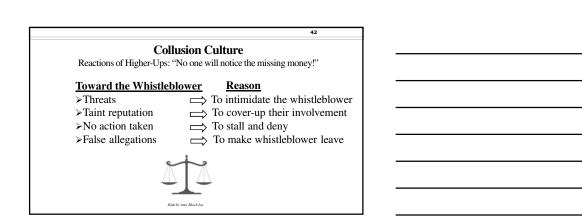
Spread gossip ⇒ To reduce credibility

Shun ⇒ To keep in the dark

Isolate ⇒ To promote silence

Intimidate ⇒ To stop the whistleblower

Collusion Culture Reactions of Colleagues: "I need job security!" Toward the Wrongdoers Fear Fear Secret discussions Encircle Support Fare a condition in the property of the propert



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
- $\bullet~\$150\mbox{K}$ 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



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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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



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.

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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.

5:

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 201

