

Lessons Learned from Pasadena's \$6M Embezzlement

**Beach Cities Chapter – Institute of Internal Auditors
Annual Professional Seminar**



**Presentation by Laura L. Doud, City Auditor
City of Long Beach
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- ▶ The City of Pasadena has enjoyed a reputation for being a well-run municipality.
- ▶ The City has received multiple awards for excellence from the California Society of Municipal Finance Officers and the Government Finance Officers' Association.



The differences between what happened in
the City of Bell and the City of Pasadena.



What happened in the City of Pasadena
and how was it discovered?



KPMG Audit Findings:

- ▶ Revealed 296 fraudulent invoices resulting in 189 checks totaling \$6.4 million.
- ▶ There was no oversight of the Underground Utilities Program by the City Engineer or Director of Public Works and no oversight of the employee in question.



KPMG Audit Findings:

- ▶ There were no written procedures in place outlining duties and responsibilities of personnel working in that program.
- ▶ There was no procedure in place to ensure that invoice amounts billed by vendors were for actual work performed.



KPMG Audit Findings:

- ▶ This one employee approved vendor invoices that he himself prepared; he submitted invoice payment requests to Accounts Payable --- and he picked up the printed checks along with the invoices!



KPMG Audit Findings:

- ▶ Basic chain of custody principles did not exist. Invoices approved by Accounts Payable were handed back to the employee who prepared them.
- ▶ Payment requests were often submitted using photocopies.



KPMG Audit Findings:

- ▶ There was no dollar threshold for higher levels of approval.
- ▶ A valid and current master vendor list is a best management practice to prevent unauthorized payments. The city's master vendor list was simply a list of everybody who has received payment, not a list of those authorized through a procurement process to receive payment.



KPMG Audit Findings:

- ▶ The city had no vetting process for new vendors.
- ▶ The city had no procurement policy requiring competitive bidding.
- ▶ The city did not adhere to a 1099 vendor identification and reporting process in this case. It had no W-9 requirement, and apparently there was no reporting by the city to the IRS of payments over \$600.



KPMG Audit Findings:

- ▶ While the city has written purchasing requisition and order policies and procedures to ensure an audit trail, the employee routinely submitted vendor invoice payment requests that were not supported by a purchase order contract, and Accounts Payable went ahead and processed check payments. Invoices were not matched to purchase orders.



KPMG Recommended a Few Basic Practices:

- ▶ Validate payment request information prior to payment.
- ▶ Document the review and approval of payment requests.
- ▶ Adhere to a chain of custody for invoice payment documents. Individuals submitting invoices should not have access to the invoices they submit until after checks have been cut.
- ▶ Accept only original documents with original signature authorizations.



KPMG also recommended the reestablishment of an internal audit function.



FRAUD TRIANGLE





FRAUD RISK

Conditions that may indicate a risk of fraud:

- The nature of the entity's operations provide opportunities to engage in fraud;
- Management is willing to accept unusually high levels of risk in making significant decisions;
- Operating policies and procedures have not been developed, are outdated or not being followed;
- Key documentation is lacking or does not exist; improper payments, and
- Unusual patterns and trends in contracting, procurement, acquisition, and other activities of the program.

~U.S. Government Accountability Office
Comptroller General of the United States

QUESTIONS?



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