

The State Inspector General's Annual Report of Fraud
Conducted by Executive Branch State Employees
Fiscal Year (FY) 2015-2016

The State Inspector General (SIG) tracks fraud conducted by Executive Branch employees to assist State agencies in their investigations; serves as an indicator of integrity within the Executive Branch workforce; and transparently reports to the public to maintain its confidence in the integrity of State government. At this time, the SIG does not track frauds conducted by third parties against the State, such as tax, Medicaid, pharmaceutical diversion, SNAP, or contract fraud, most of which are investigated by sworn law enforcement personnel residing in the respective State agencies.

The SIG identifies Executive Branch employee fraud through mandatory reporting by each agency; law enforcement reporting; agencies' annual reports to the Office of the Comptroller General; and open source reporting. In FY 2015-2016, the SIG received twelve (12) notifications of fraud involving 18 Executive Branch employees at ten statewide agencies, which resulted in estimated losses of \$1,188,529 in the below categories:

Fraud Scheme Category	Number of Reports	Fraud Losses by Scheme
Procurement Fraud	5 (42%)	\$ 402,169 (34%)
Theft	1 (8%)	\$ 10,000 (1%)
Embezzlement	4 (33%)	\$ 376,360 (32%)
Contract/Grant Fraud	2 (17%)	\$ 400,000 (33%)
Bribery	--	--
TOTALS	12 (100%)	\$1,188,529 (100%)

Below is a year-over-year comparison of past three FYs reported fraud schemes:

Fraud Scheme Category	FY 2015-16 Reported Incidents	FY 2014-15 Reported Incidents	FY 2013-14 Reported Incidents	FY 2015-16 Total Fraud Losses	FY 2014-15 Total Fraud Losses	FY 2013-14 Total Fraud Losses
Procurement Fraud	5	2	6	\$ 402,169	\$ 2540	\$ 425,781
Contract/Grant Fraud	2	1	2	\$ 400,000	\$ 0	\$ 80,000
Embezzlement	4	4	1	\$ 376,360	\$362,410*	\$ 28,045
Theft	1	6	6	\$ 10,000	\$ 14,736	\$ 9765
Bribery	0	0	1 +	\$ 0	\$ 0	\$ 0
Totals & Average Loss	12	13	16	\$1,188,529	\$379,686	\$543,591

*Initial payroll fraud scheme loss of \$256,527 was revised to \$337,410 at sentencing in 09/2016.

+Bribery scheme interrupted during federal wiretap investigation. No loss to the State.

Analysis of FY 2015-16 results developed the following observations:

- FY 2015-16 losses (\$1,188,529) are up 157% over the average of the two prior FYs (\$461,638), while the FY 2015-16 incidents (12) were down 17% over the prior two FY average (14.5). This obviously resulted in a higher FY 2015-16 loss per incident of \$99,044 compared to the prior two FYs of \$31,837.
- For FY 2015-16, the job levels for the 18 executive branch employees committing fraud were: two (11%) executive level employees; six (33%) supervisors; and ten (56%) front line employees. This represented the highest number of executive and supervisory level employees committing frauds over the past three FYs, by far, which logically correlates with higher fraud losses.
- Of the twelve fraud schemes reported, the majority of cases were initiated by alert reporting from co-workers or customers of suspicious activity (58%), followed by discovery through routine audits (42%).

- Of the 12 fraud schemes reported, three can be attributed to the immediate supervisor's failure to properly use the existing internal control approving a subordinate's (subject) financial transactions; two can be attributed to internal control gaps (inappropriate access; lack of surprise petty cash audits); four due to subject falsifying documents to override internal controls; and two instances where internal controls identified suspicious activity led to identifying the fraud.

The most illustrative "lesson learned" was gleaned from examining the four major frauds [a contract award fraud and kickbacks (\$400,000); two procurement frauds (\$341,164); and an embezzlement (\$336,000)], which accounted for 90% of the total FY 15-16 losses. The common element was the subject(s) in each fraud were in management positions, which dramatically increased the fraud risk and potential loss. As a fraudster rises in management, it provides greater opportunity to override internal controls, access to larger funds/assets, and increases the ability to conceal by extending the length of the fraud, all of which lead to proportionally larger losses than schemes perpetrated by front-line employees.

These 12 frauds also reinforce the fundamental principles to prevent fraud: 1) raise employee awareness to report suspicious activity; and 2) managers properly executing routine existing internal controls in a thorough manner.

Again, the SIG takes note of the fact agencies may be underreporting fraud and choosing instead to terminate the employment of those found to have engaged in fraud against the state agency without further consequence. The Office of the Comptroller General (OCG) requests all agencies identify frauds in conjunction with its annual statewide financial audit, yet none of the ten state agencies represented by the twelve fraud incidents reported these fraud matters in the OCG's annual master report. This gives credence to the anecdotal claims by some statewide internal auditors that agencies are underreporting fraud with the respective agency.

In summary, the 12 fraud incidents totaling \$1,188,529 indicates a low risk of employee fraud in the Executive Branch given its \$26 billion budget and 60,000 employees. However, the first two years of this SIG annual fraud report (FYs 2013-14 & 2014-15) had a pattern of one major fraud in the \$300,000 - \$400,000 range along with 12 to 14 nominal frauds. In the most recent FY 2015-16, there were four major frauds in the six figure range (\$125,000 - \$400,000), which should be noted by Agency Heads and financial managers. A major fraud can potentially damage an agency's reputation and undermine the public's confidence in the Executive Branch. State government agencies are essentially a large partnership, where a negative event caused by one agency has the tendency to undermine the public's confidence in all State agencies.

ADMINISTRATIVE NOTE: Vignettes describing the twelve frauds during FY 2015-2016 can be found at the following link: <http://oig.sc.gov/Documents/Vignettes-Fraud-2015-2016-Final.pdf>