



# **CSMFO CONFERENCE 2018**

**Fraud:**  
**A Story of Embezzlement, Response, and Resilience**

**February 22, 2018**

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## Objectives

- Hear a real life story about a large embezzlement in the City of Placentia and how the City responded diligently with strategic measures to ensure a strong recovery to regain the public's trust.
- Learn how to establish the critical partnerships, team, and internal controls necessary to build transparency and confidence in the City's finances, both internally and externally.
- Obtain a better understanding of lessons learned, and best practices to ensure your city is safeguarded from fraud.



# Fraud: A Story of Embezzlement, Response, and Resilience February 2018



# Day 1

April 12, 2016

- IRS contacts City to report wire transfers
- Nguyen admits to initiating some wire transfers
- 17 unauthorized wire transfers discovered after search of City bank records
- \$4.3 Million initial loss
- Nguyen placed on administrative leave
- OC District Attorney contacted by City to conduct investigation



# The Fraud Continues to Unfold

April 13, 2016

- Nguyen attempts to have fellow employee reverse \$1.8 Million in transfers
- Nguyen found to be initiator AND approver of wires
- Nguyen arrested and bail set at \$4.3 Million

April 14, 2016

- Search warrants issued at multiple banks; over \$2.9 Million seized



# City Losses

Between January 27, 2014 and April 12, 2016

- 36 unapproved wire transfers
- \$5,160,735.00 transferred to Nguyen or his DBA and two separately charged individuals
- Orange County District Attorney recovered \$2,932,618.76 by search warrant
- \$2,649,155.57 net loss to City after other incurred costs



# Prosecution

April 14, 2016

- Nguyen charged with 17 counts of Misappropriation of Public Funds

June 17, 2016

- 19 counts of Misappropriation of Public Funds
- 66 counts of money laundering, and 1 count NSF check added
- Total taking \$5,160,735.00
- Maximum possible sentence 97 years, 8 mos.



# Prosecution (Continued)

December 8, 2016

- Preliminary Hearing held

February 8, 2017

- Nguyen arraigned

March 10, 2017 (*11 months after fraud discovery*)

- Nguyen plead guilty to all charges and enhancements
- Victim impact statement
- Sentenced to 25 years in State Prison
- Ordered to pay \$2,649,155.57 in restitution
- Fined \$10,321,471.00



# Prosecution (Continued)

February 23, 2017

- Herbert Norris Trotter charged with 14 counts of Misappropriation of Public Funds, 14 counts of money laundering, and sentencing enhancements. Bail set at \$2.3 Million and case is in pre-preliminary hearing status.
- Michael Todd McDonald charged with 15 counts of Misappropriation of Public Funds, 46 counts of money laundering, and sentencing enhancements. Bail set at \$2.3 Million and he has been found not competent to stand trial.



# Early Responses

- Immediately contact the District Attorney
  - Building a strong relationship with the DA is **critical**
  - Continue to work closely with the DA during investigation and recovery
- Manage the crisis both internally & externally
  - Create calm with City Council and Staff
  - Form a good rapport with local media
- Independent investigation
- Contact the insurance company within the first week of discovery



# How to Come Out On Top

## Formulate a 3-Pronged Recovery Strategy

- Secure the monies from former employee including personal accounts, fake vendors, CalPERS, last paycheck and investment accounts
- Recover monies/damages from other parties
- File a timely Crime Insurance Claim

## Best Practices – Policies & Procedures

- Strengthen existing policies
- Create new financial policies, procedures & practices



# Transparency + Recovery = Trust

- Keep in front of it – communicate with the Council, the Media, and the Community
- Use a PR firm, focus on getting justice and involve Council in the message
- Use PR strategies
- Show that you have a plan...instill confidence
- Build trust with communication in Closed Session



# Transparency + Recovery = Trust

- Keep employees informed
- Public updates during CC meetings and City website
- Be thorough - DA Investigation, Independent investigation and Independent forensic auditor
- Show Transparency...hand over the reigns on certain items



# Recovery

- Total taking: \$5.16M
- Total Recovery to date: \$4.7M
- Approx. \$500k remaining
- Make sure everyone (Council, community, media and staff) knows that you're going after everything
- Evaluate recovery at every stage – return on pursuit costs
- Still in the final stages of recovery



# Top Things You Can Do NOW

- Wire Transfers (2 Stage-Triple Redundancy)
- LAIF Transactions (2 Stage-Triple Redundancy)
- Bank Statement Direct Access & Redundancies
- Finance Separation of Duties & Organizational Chart
- Custodian of Authorization/Enterprise Tracking System
- Electronic Disbursement Register
- Security of Credit Card Machines Policy
- Fraud Hotline
- Facilitate a “See Something, Say Something” Culture



# Top Things You Can Do NOW

- Computer Lock Out & Exploration of Additional Technology
- PD Daily Deposits vs Weekly Void Check Policy
- Finance & Management Personnel Credit Check
- Selection of Banking Services & External Controls
- Unclaimed Payroll & Accounts Payable Checks
- Check Stock Storage & Security
- Credit Card Use Policy
- Gas Card Use Policy
- Financial Accounting Software upgrade
- Selection of New Auditors & Additional Testing



## "The Auditor"



*"Once upon a time there was a very, very scary man called the Auditor..."*

Source: Barron's  
March 2010

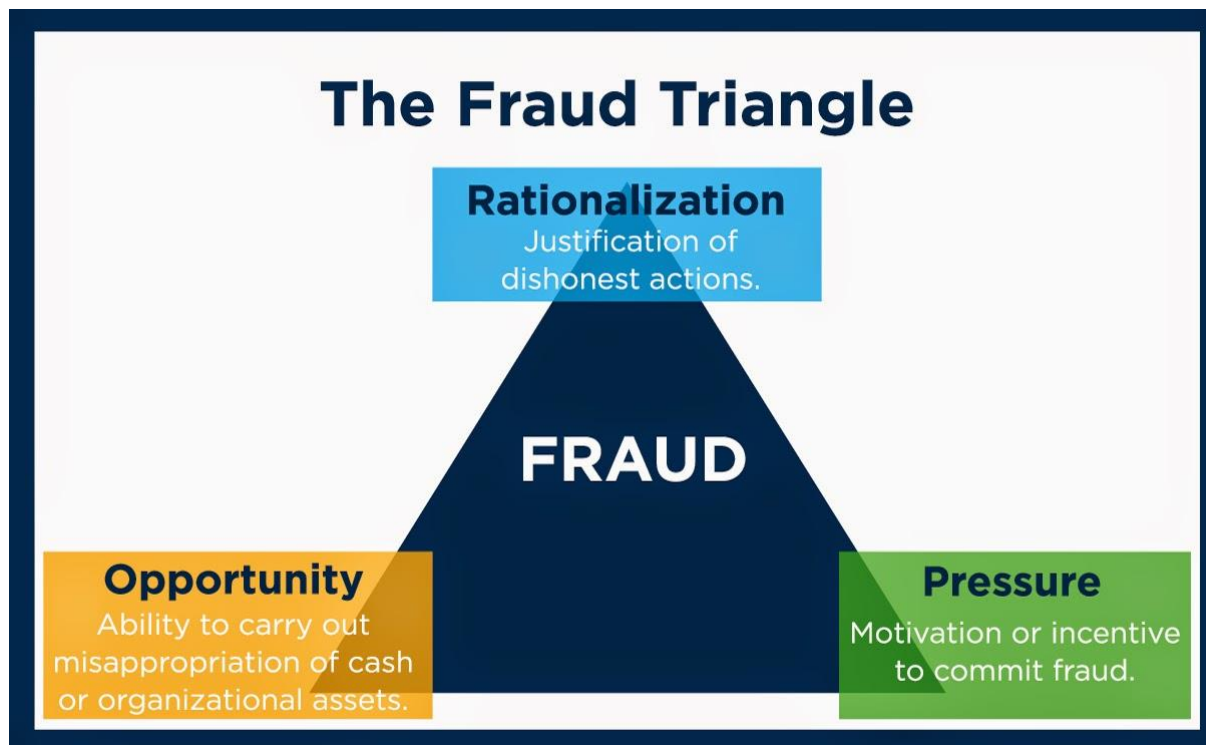
## What is Fraud?

- Wrongful or criminal deception intended to result in financial or personal gain
- A person or thing intended to deceive others, typically by unjustifiably claiming or being credited with accomplishments or qualities



## Fraud Triangle

- The fraud triangle is a model for explaining the factors that cause someone to commit occupational fraud. It consists of three components which, together, lead to fraudulent behavior:





## **Report to the Nations on Occupational Fraud and Abuse**

Source:  
ACFE's 2016 Global Fraud Study

# THE STAGGERING COST OF FRAUD

Source:  
ACFE's 2016 Global Fraud Study

CFES ESTIMATE THE TYPICAL ORGANIZATION  
**LOSES 5% OF ANNUAL REVENUES TO FRAUD**



Source:  
ACFE's 2016 Global Fraud Study



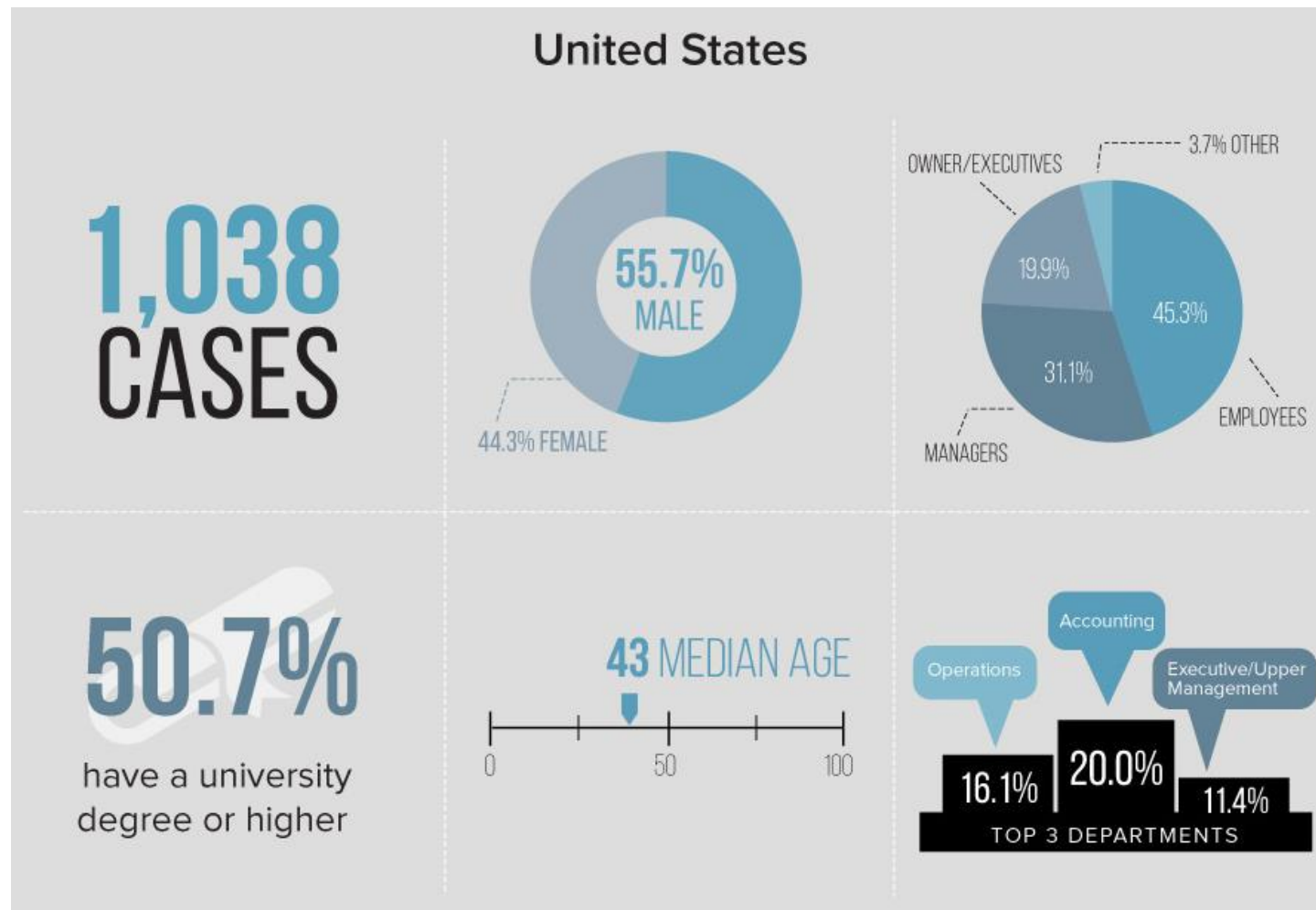
**MORE THAN 23%** OF OCCUPATIONAL FRAUD  
CASES RESULTED IN A LOSS OF AT LEAST  
**\$1 MILLION**

Source:  
ACFE's 2016 Global Fraud Study

## VICTIM ORGANIZATIONS THAT **LACKED ANTI-FRAUD CONTROLS** SUFFERED GREATER MEDIAN LOSSES—**IN FACT TWICE AS MUCH**



Source:  
ACFE's 2016 Global Fraud Study



Source:  
ACFE's 2016 Global Fraud Study

## Behavioral Red Flags

- Living Beyond Means
- Financial Difficulties
- Unusually Close Association with Vendor/Customer
- Wheeler-Dealer Attitude
- Control Issues, Unwillingness to Share Duties
- Divorce/Family Problems
- Irritability, Suspiciousness or Defensiveness
- Addiction Problems
- Complained About Inadequate Pay
- No Behavioral Red Flags

## Behavioral Red Flags (Continued)

- Refusal to Take Vacation
- Excessive Pressure from Within Organization
- Past-Employment-Related Problem
- Social Isolation
- Past Legal Problems
- Other
- Excessive Family/Peer Pressure for Success
- Complained about Lack of Authority
- Instability in Life Circumstances

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# Responsibilities

- **Management**

- Tone at the Top
- Establish and maintain proper internal control
- Policies and Procedures
- Anti-Fraud Control

- **Auditors**

- Assess Risk of Material Misstatements – including Fraud Risk
- “Reasonable Assurance” – What does that mean to you?
  - Free from material misstatements – Whether due from error or **FRAUD**
- Professional Skepticism

## Message Point

- Duty to Ensure Those Charged with Governance Have Financial Awareness
- Be Proactive in Identifying Solutions
- Obtain or Recommend Expert Help
  - **Forensic Auditor:** An independent forensic audit was conducted through the City Attorney's Office by KPMG.
  - **Personnel Investigation:** An independent personnel investigation, utilizing an outside investigator, was conducted.
- Be Transparent
  - Confront brutal facts
  - All findings and recommendations from the investigations were presented to the City Council at a public meeting.

# QUESTIONS?

