

# Ohio Association of Public Treasurers

## Theft in Public Office

Presented by Sara M. Costanzo

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1

## Today's Agenda

- Theft in office, embezzlement and fraud
- Federal and state laws
- Red flags
- Avoiding losses
- Case examples



2

2



## Theft in Office, Embezzlement and Fraud

3

### Just the Facts

- Statistic:
  - Between the time Dave Yost took office as the Auditor of the State of Ohio, and March of 2018, the office convicted 146 former public officials and employees
- Ohio State Auditor's Office Special Investigations Unit
  - In the past 4 years:
    - 85 convictions for fraud on 130 charges, resulting in 148 findings for recovery.
    - Total findings so far: \$15,759,287
  - Fraud hotline at 1-866-372-8364



4

# Just the Facts

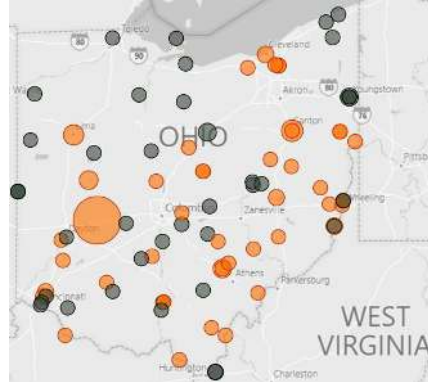
## Special Investigations Unit convictions since January 2019

All of these cases involved the work of the Auditor of State's SIU, including forensic audits, fraud investigations, and/or prosecutions.

An asterisk (\*) denotes a case resolved with a sentence of Diversion in lieu of conviction

Orange denotes a **Theft in Office** conviction

88 Convictions     \$4,844,239.87 Sum of Restitution



# Theft in Office

## Theft in Office

- A theft in office charge applies when a public official – any public employee – uses his or her office to commit one of the various crimes categorized as theft: tampering with records, forgery, telecommunications fraud and passing bad checks, among others.
  - <https://ohioauditor.gov/news/pressreleases/details>



7

7

## Theft in Office

- Section 2921.41
- (A) No public official or party official shall commit any theft offense, ... when either of the following applies:
  - (1) The offender uses the offender's office in aid of committing the offense or permits or assents to its use in aid of committing the offense;
  - (2) The property or service involved is owned by this state, any other state, the United States, a county, a municipal corporation, a township, or any political subdivision, department, or agency of any of them, is owned by a political party, or is part of a political campaign fund.



8

8

## Embezzlement

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### Embezzlement

- Involves the fraudulent appropriation of property or money that someone has been entrusted with, to utilize it for their own benefit
- Could be cash, company checks, jewelry, electronics, or even postage stamps

## Embezzlement *Cont.*

- Different from regular theft because the person who takes the money or property generally has trusted and legitimate access to the valuables before they take them for their own use
- Can take a variety of forms:
  - A cashier taking a small amount of cash out of a cash register on a single occasion
  - A more sophisticated embezzlement scheme, using phony vendors and invoices to steal millions of dollars over a period of years



11

11

## Embezzlement *Cont.*

- In 2017, state audits uncovered \$3.4 million in missing funds over the decade prior from 77 government groups across the state.
- Many cases were connected to theft, with 53 convictions resulting.
- 20 of those 77 cases were inside the utility clerk's office, most often involving cashier-level employees who deal directly with community members for payment intake.

*\*Ohio Auditor's Office*



12

12

## Embezzlement Cont.

| Entities with Findings since 2007 |    |
|-----------------------------------|----|
| Villages                          | 22 |
| School Districts                  | 15 |
| Courts                            | 8  |
| Counties                          | 7  |
| Cities                            | 6  |
| Agricultural Societies            | 3  |
| Libraries                         | 3  |
| Health Departments                | 2  |
| Sheriff's Departments             | 2  |
| Townships                         | 2  |
| County Treasurer's Office         | 2  |
| Ambulance District                | 1  |
| Charter School                    | 1  |
| Environmental Services District   | 1  |
| Park District                     | 1  |
| Water and Sewer District          | 1  |



\*Ohio Auditor's Office

13

13



## Types of Embezzlement

14

## Types of Embezzlement

- Adjusting journal entries
- Void schemes
- Check substitutes
- Fictitious vendors
- Expense report padding



*\*Hiscox Embezzlement Watchlist*

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15

15

## Adjusting Journal Entries

- Background:
  - Certain situations require changes to the balance on a customer's account to correct billing errors, such as inaccurate meter readings or erroneous late fees.
  - Employees typically remedy these mistakes by creating entries in the entity's billing system, called non-cash adjustments.
    - This either increases or decreases the account balance to the proper amount owed.

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16

16



## Adjusting Journal Entries Cont.

- For example: an employee who receives a customer's payment does not record the transaction as a payment in the billing system.
  - The employee pockets the cash and creates a fraudulent adjustment to lower the customer's account balance back to zero.
  - Employees are more discreet and steal only part of a customer's payment, adjusting the account balance only enough to offset the stolen amount.



17

17

## Void Schemes

- Background:
  - As many entities transition to web-based payment options, cash registers still prove useful for citizens who prefer to pay in person for utility payments, title and permit fees, and other public services.
  - Wherever cash registers are present, there also exists a need to cancel erroneous payments through voids.
  - When this procedure goes unchecked, local government dollars are left vulnerable to thieves who characteristically seek opportunities for fast money and an easy way to sweep their crimes under the rug.



18

18

## Void Schemes Cont.

- The tactic works by manipulating an entity's paper trail to appear as if a customer's payment was refunded.
  - After a customer makes a payment, the offending employee re-enters the billing system and voids the transaction.
  - This maneuver shows the funds exiting the entity's system, allowing the employee to pocket the customer's payment with little evidence left on the government's side of the transaction.



19

19

## Substitute Check Scheme

- Local governments occasionally receive atypical revenue in the form of mailed checks for rebates, insurance claims, and other one-off payments.
  - These unexpected checks are a welcome sight for thieves looking for fast money and an easy cover-up.
- In a check-substitution scheme, an employee with access to the entity's mail stumbles upon one of these checks and sets it aside until it is time to strike.



20

20

## Substitute Check Scheme Cont.

- For example: a fiscal officer receives a letter that contains a \$100 rebate check for an equipment purchase.
  - Instead of recording the check in the accounting system, the fiscal officer discretely slides the check into a desk drawer and waits for a few customers to make cash payments.
    - The perpetrator must wait for enough customer cash payments to accumulate to a sum that covers the check amount and avoids drawing attention.
    - Then the fiscal officer substitutes the rebate check for an equal value of \$100 from the customer payments.



21

21

## Substitute Check Scheme Cont.

- A deposit slip that lists \$500 in cash will no longer match the actual amount of cash inside the bank bag if someone substitutes a \$100 check.
  - While the overall amount recorded on the deposit slip is still accurate, only \$400 in cash is present in the bank bag.
  - The bank bag now contains an extra \$100 check that is absent from the deposit slip and the accounting system.



22

22

## Fictitious Vendors

- Background:
  - Fictitious vendor fraud generally involves an employee in a position where they can create, authorize, or approve payments to vendors.



23

23

## Fictitious Vendors Cont.

- An employee may set up a legitimate-looking business and create invoices from that business, submitting them to the company for work that was never done, or goods that were never provided.
  - The company or employee will approve the payment and send it to fraudulent company.
  - The employee will deposit the payment for their own use, in some cases using money laundering techniques to distance themselves from the cash.



24

24

## Fictitious Vendors Cont.

- Employees who engage in fictitious vendor embezzlement may start out converting small amounts of money, testing their scheme, and later get more ambitious, possibly taking millions of dollars before their fraud is ever detected.
- A man in Ohio was charged with embezzling almost \$9 million in his position as an accountant through a fictitious vendor scheme over the course of more than 10 years.



25

25

## Expense Report Padding

- Background:
  - Expense reimbursement fraud makes up about 15% of business fraud.\*
  - It takes an average of about 24 months before expense report fraud is detected.

\*The Association of Certified Fraud Examiners



26

26

## Expense Report Padding Cont.

- Types of expense report fraud:
  - Claiming non-business related items
  - Inflating acceptable expenses – a \$5 Uber turns into a \$15 Uber charge (generally receipt is missing)
  - Overcharging the company card
  - Double billing – charging an item more than once, under separate events/trips
  - Exceeding the limits for allowable expenses - splitting large amounts into two or three items on the expense report

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27

27

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**Fraud**

28

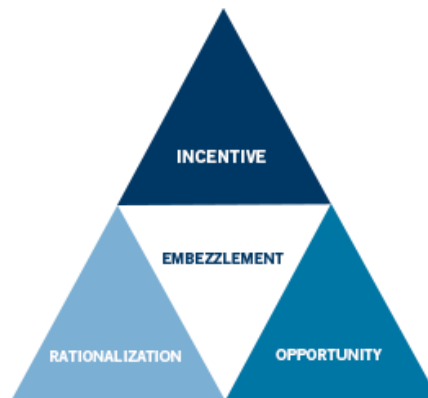
## Fraud

- Involves the improper appropriation of property or money that someone has been entrusted with, to utilize it for their own benefit
  - Chapter 2913 of the Ohio Revised Code states that fraud, as a criminal act of deception, means
    - knowingly deceiving another or causing another to be deceived by any false or misleading representation, withholding information, preventing another from acquiring information, or by any other conduct, act, or omission.



## Fraud Triangle

- Incentive/pressures
- Opportunity
- Rationalization



## Incentives or Motivation/Pressures

### Personal financial pressures:

- Standard of living
- Living beyond means
- High personal debts or poor credit
- Student loan repayments
- Extended family issues
- Vices
- Unexpected crisis
- Change in life situation

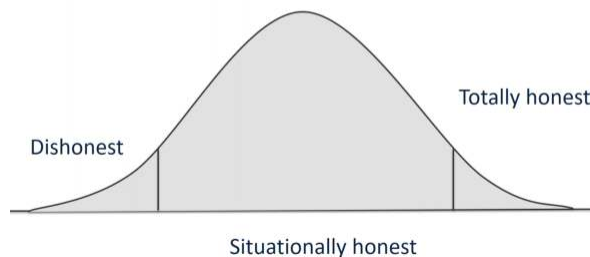
### Organizational financial pressures:

- Staffing issues
- Workload increase for those who remain
- Reimbursement reductions
- Shrinking budgets
- Increase in costs
- Regulatory pressures



## Rationalization

### Rationalization theory

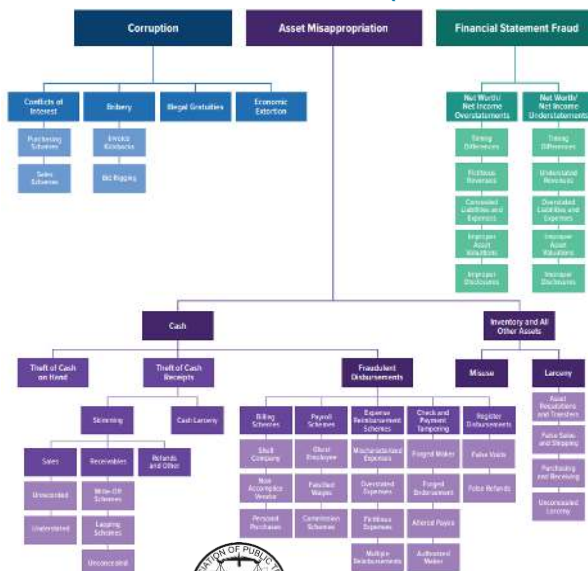




# Who Commits Fraud

33

## Fraud Classification (Fraud Tree)

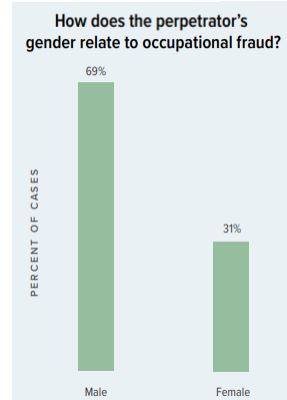
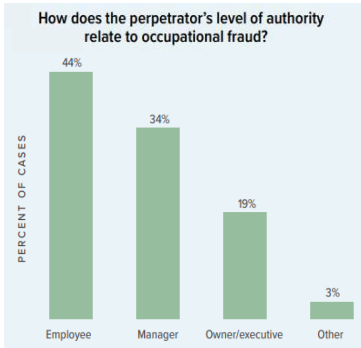


34

## Fraud – Who Commits

**2,690**

real cases of occupational fraud



\*2018 ACFE Report to the Nations

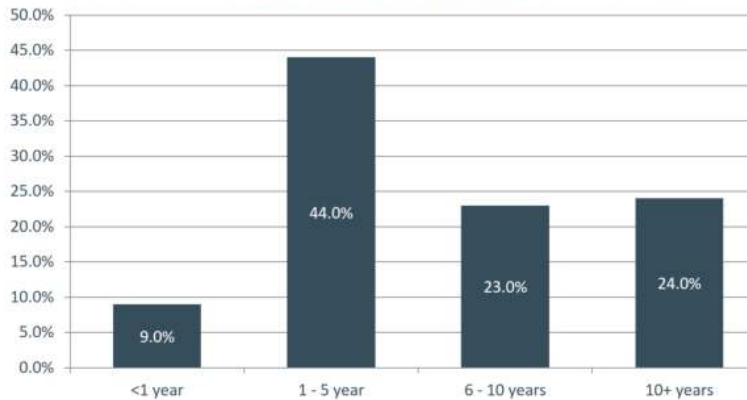


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## Fraud – Who Commits Cont.

Tenure of Perpetrator in Organization-amount of loss increases with more years employed



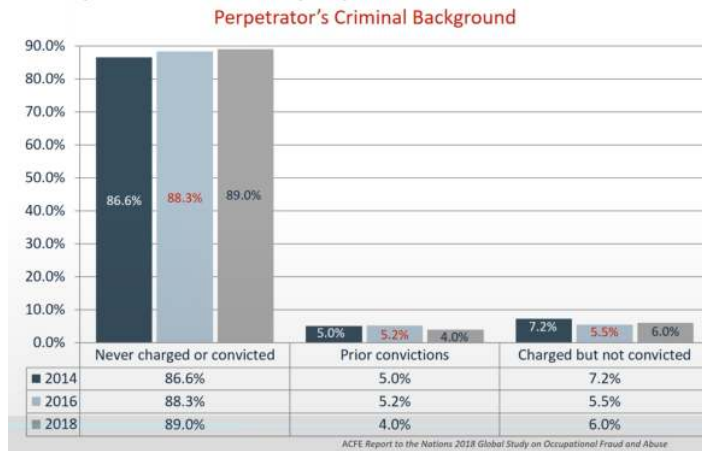
ACFE Report to the Nations 2018 Global Study on Occupational Fraud and Abuse



36

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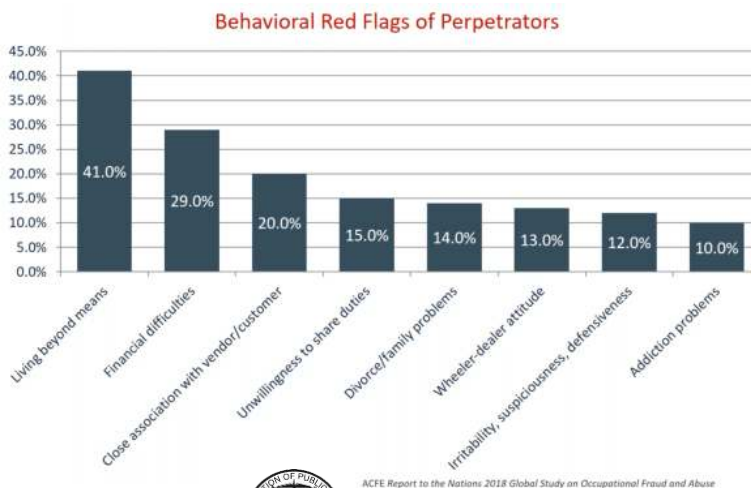
## Fraud – Who Commits Cont.



37

37

## Fraud – Who Commits Cont.



38

38

## Federal and State Laws

39

### Federal and State Laws

- Fraud crimes can be prosecuted at either the state or federal level, depending on a number of factors:
  - Type of fraud scheme and amount of money stolen
  - Laws violated (federal, state, or both)
  - Method of operation
  - Use of public services (such as the U.S. Postal Service, telecommunication systems, and Medicare) that fall under federal or state regulation and authority
  - Location of the crime (within a state or across state or national borders)

## Federal Laws - Penalties

- Federal fraud crimes are typically charged as felony offenses, though misdemeanor convictions are possible in certain situations.
  - The difference between a misdemeanor offense and a felony offense is that a felony has a potential sentence of a year or more in prison, while misdemeanor convictions can result in a prison sentence of up to one year.
  - There are a wide range of potential penalties for any federal fraud conviction, though they typically involve prison, fines, or probation.



## Federal Laws – Penalties Cont.

- **Prison:** Someone convicted of a federal fraud crime faces serving time in a federal.
- **Fines:** The fine for any conviction of a federal fraud law can be extremely high.
- **Restitution:** Restitution is paid by perpetrators of fraud to the victims in order to compensate them for their losses.
- **Probation:** A federal judge can impose a federal probation sentence individually or in combination with a fine or a term of imprisonment in some situations.



## Ohio Laws

- January 8, 2021
  - Governor signed Senate Bill 10
  - Increases the penalties to an F-2 for stolen amounts between \$150,000 and \$750,000 and an F-1 for amounts of loss greater than \$750,000.
  - Maintains that anyone who is found guilty of theft in office would be disqualified from holding any future public office, employment or position of trust in the state.
  - Require the offender to pay back the forensic audit cost when the victim is a public entity.



43

43

## Ohio Laws

- Fraud Reporting
  - All public offices, including community schools, must provide information about the fraud reporting system and the means of reporting fraud to all new hires.
    - All new employees must confirm that they received this information within thirty days after beginning employment.
  - Ohio Revised Code §117.103 requires the Auditor of State to confirm during the course of an audit, as provided in Ohio Revised Code §117.11, that public offices have so notified new employees.
    - The statute provides two ways to verify compliance: by signature acknowledgement or in a manual.



44

44

## Ohio Laws - Statutes of Limitations

- Felonies and misdemeanors
  - Like many states, Ohio's law sets time limits for a host of specific crimes. For crimes not specifically listed in the statute, a general statute of limitations applies based on the category of the crime.
  - The general time limits are:
    - Six years for felonies
    - Two years for misdemeanors
    - Six months for minor misdemeanors
  - (Ohio Rev. Code Ann. § 2901.13 (2019).)



## Ohio Laws - Statutes of Limitations *Cont.*

- Theft-related and fraud offenses
  - **Identity fraud:** Six years after the crime, or if this period has expired, five years after discovery of the offense
  - **Misconduct by public servant:** Any time while the person remains in office or in their position, or two years after leaving office or the position
  - **Offenses involving fraud or breach of fiduciary duty:** One year after discovery of offense (if the underlying time limit has expired)
  - **Felony theft (\$1,000 or more):** Six years after the crime
  - **Misdemeanor theft (less than \$1,000):** Two years after the crime



## Red Flags

47

### Red Flags

- Depending on the individual, their job, and the type of fraud, it can take years to discover fraud. In some cases, fraud may never be discovered at all.
- A number of red flags can alert the possible fraud.
- Be aware of behavioral red flags.
- Set up and monitor a strong system of internal controls.
- Utilize anti-fraud controls.
- Utilize data analysis software.

48



## Red Flags *Cont.*

- Things to watch for:
  - Employee lifestyle changes: expensive cars, jewelry, homes, boats
  - Refusal to take vacation or sick leave
  - Poorly defined duties without adequate monitoring
  - Behavioral changes that may indicate substance abuse or gambling problems, or just fear of losing job
  - High employee turnover, especially in areas more vulnerable to fraud
  - Reluctance to provide information to investigators
  - Management decisions dominated by an individual or small group



49

49

## Red Flags *Cont.*

- Things to watch for:
  - Disrespect for regulatory bodies
  - Excessive or unauthorized voided receipts
  - Lax or inexperienced accounting personnel
  - Inordinant number of manual checks
  - Excessive number of checking accounts
  - Frequent changes in banking accounts
  - Frequent changes in external auditors
  - Under-market-value sales of company assets
  - Significant downsizing in a healthy market



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## Red Flags *Cont.*

- Things to watch for:
  - Continuous rollover of loans
  - Excessive number of year-end transactions
  - Unsupported transactions or adjusted journal entries
  - Unexpected overdrafts or declines in cash balances
  - Any financial transaction that doesn't make
  - Service contracts for which there is no product
  - Photocopied or missing documents
  - Altered records
  - Refusal to use serial-numbered documents
  - Compensation program that is out of proportion



51

51

## Red Flags *Cont.*

- In Purchasing/Inventory:
  - Abnormal number of expenses, supplies or reimbursements
  - Purchases that bypass normal procedures
  - Handwritten or typed invoices vs. computer-generated
  - Increased complaints about products or service
  - Increase in purchasing without increase in sales
  - Acceptance of gratuities or significant "promotional" items
  - Handwritten check endorsements vs. stamped endorsements



52

52

## Red Flags *Cont.*

- In Purchasing/Inventory:
  - Abnormal inventory shrinkage
  - Prepayment of goods or services
  - Frequent use of sole-source contracts
  - Pressure to expedite payments
  - Lack of physical security over assets/inventory
  - Charges without shipping documents
  - Payments to unapproved vendors
  - High volume of purchases from new vendors
  - Vendors without physical addresses
  - Vendor addresses that match employee addresses



53

53

## Red Flags *Cont.*

- In Purchasing/Inventory:
  - Inventory that is slow to turn over
  - Lack of defined duties
  - “Consulting” contracts for which there is no end product
  - Deviation from specifications on delivered goods or services
  - Numerous duplicate payments, then pocketing the refund
  - Prepayment of goods or services
  - Purchasing agents who pick up vendor payments rather than having them mailed



54

54

## Red Flags *Cont.*

- Credit Cards (corporate):
  - Minimal or no supporting documentation for charges (for example, summary charge slips vs. detailed receipts)
  - No or minimal policies regarding access and use of credit cards
  - No or unreasonably high limits
  - No restrictions on types of purchases
  - Inappropriate charges noted on statements



55

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## Red Flags *Cont.*

- Payroll:
  - Overtime charged during a slack period
  - Employees with duplicate Social Security numbers, names or addresses
  - Overtime charged for those who normally would not have overtime wages
  - Inconsistent overtime hours for a cost center
  - Budget variations for payroll by cost center
  - Employees with few or no payroll deductions



56

56

## Red Flags *Cont.*

- Accounts Receivable:
  - Excessive number of voided receipts, customer discounts and returns
  - Customers complaining of non-payment notices
  - Unauthorized bank accounts
  - Unauthorized voided receipts, customer discounts, or returns
  - Unauthorized account adjustments or write-offs
  - Untimely deposits
  - Sudden activity in a dormant bank account
  - Unjustified cash transactions



57

57

## Red Flags *Cont.*

- Accounts Receivable:
  - Large number of account write-offs
  - Unreconciled bank accounts
  - Cash register shortages or overages
  - Increase in past-due accounts
  - No collection efforts on past-due/written-off accounts
  - Cash payments when checks are expected
  - Unexplained drop in revenue despite same level of sales
  - Discrepancies between bank deposits and posting



58

58

## Red Flags *Cont.*

- In some cases, discovery of the fraud will come from a tip from a co-worker or someone who suspects the employee is taking money or property.
- Upon discovery of possible fraud, a company may conduct an internal investigation or take the information directly to law enforcement.



59

59

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Avoiding Losses

60

## Avoiding Losses – Any Recovery



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61

61

## Avoiding Losses

- Control cash receipts – issuing for all cash transactions in duplicate.
- Post all payments to a billing system.
- Routinely reconcile money in hand with documented deposits.
- Prepare bank deposit slips daily.

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62

62

## Avoiding Losses *Cont.*

- Review spending trends over time between similarly-situated employees.
- Educate employees and train managers on approving expense reports.
- Consider an automated expense management system.
- Use purchase orders.



63

63

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Case Examples

64



## Case Examples

- East Cleveland Police Chief, Scott Gardner, pled (not) guilty to felony financial crimes, having been indicted on charges of aggravated theft, fraud and theft in office
  - Allegations (oddly prior conviction in 2014 CR-14-582099)
    - Falsified, destroyed, removed, concealed, altered, defaced or mutilated digital sales tax return records with the purpose to defraud (\$150,000 - \$750,000)
    - Passed several bad checks in the amount of \$16,200 with the purpose to defraud US Bank and/or the Fraternal Order of Police, Lodge 39



65

65

## Fictitious Vendor

- Robert M. Vanderhorst, 63, pleaded guilty in August 2022 in Clark County Common Pleas Court to two felony counts of theft and theft in office from 2005-2021
  - “This is one of the largest thefts committed by a public employee in our state and an egregious crime against the people of Clark County,” State Auditor Keith Faber said.
  - The whistleblower, a co-worker, found a suspicious vendor account that received county payments but had no address, no tax identification number, and no description of work being performed.
  - Sentenced to 7 years in prison & ordered to pay full restitution



66

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## Clerk of Courts

- Former deputy clerk Susan Barnett at the Lima Municipal Clerk of Court's office was sentenced in August 2022 to 3 years in prison.
  - Admitted she stole more than \$330,000 from the city between 1997 and 2012
    - Judge stated that the city to some degree helped facilitate the thefts by failing to provide adequate level of oversight and accounting practices
    - Ordered to repay \$331,706 in restitution



67

67

## Health Insurance Premiums

- Former RTA board president, George Dixon III, plead guilty to theft charges.
  - Accumulated unpaid health insurance premiums during his more than two decades with the Greater Cleveland RTA
    - Signed up for, but did not pay, the costs associated with RTA-provided health insurance
    - Ordered to repay \$132,000 in restitution



68

68

## Misuse of Credit Card / ATM & Unauthorized Expenses

- Highland Heights – Scott Coleman (former Mayor)
  - Embezzled \$160,000 from U.S. Rep. Dave Joyce's campaign
    - As treasurer of the Bainbridge township Republican's re-election operation between 2015-2018
    - Plead guilty to grand theft charges – a fourth degree felony
    - Repaid \$341,983.06 in restitution and investigative fees
    - Sentence still pending



69

69

## Adjusting Journal Entry Scheme

- Village of Ripley – Katherine Lang
  - Drained nearly \$1 million from small community of 1,750 people
    - Had been in charge of the entire collection process:
      - Creating utility accounts
      - Collecting and posting payments
      - Making deposits
    - Indicted in 2010 on three counts of theft in office and seven counts of tampering with records
    - Sentenced to 13 years in prison
    - Restitution of \$1.1 million



70

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## Void Scheme

- Montgomery County – Rozalin Smith
  - Stole \$2,092 and an additional \$12,987 through other means
    - Incoming dollars from customer solid waste payments did not match the amounts transferred to the county treasurer’s office
    - Plead guilty in 2015 to one count of theft in office and was sentenced to five years of probation and 40 hours of community service
    - Ordered to repay the stolen money



71

71

## Check Substitute Scheme

- Cuyahoga County – Debbie Bosworth
  - Stole \$238,000
    - She worked for the Village of Chagrin Falls as a clerk in the building and utility departments, processing payments, making deposits, registering contractors, and other tasks. She would take cash from water bills and swap out checks from contractors for permits.
    - Plead guilty in 2021 after being charged with two counts of theft in office, 13 counts of tampering with records, and seven counts of money laundering (22 felonies)
    - Ordered restitution of \$310,000 (to cover the cost of her theft and the forensic audit) and probation



72

72

## Pocketed Payments

- Cuyahoga County – Karla Hopkins
  - Stole \$40,000 from Maple Heights High School
    - Handled deposit of revenue from class dues, yearbook fees, auto tech, student council, flag-drill teams, book fines, and ID badge fines
    - Plead guilty in 2021 to one count of theft in office (a third degree felony)
    - Sentenced to 18 months in prison, and restitution
      - She had emptied her pension prior to being charged, which prevented the state from seizing those funds to pay back the district.

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73

73

## Pocketed Payments Cont.

- City of Marion – Brenda Nwosu
  - Stole \$34,276
    - Pocketed \$17,375 from customer payments and another \$16,901 in proceeds from incoming checks
    - Plead guilty in 2015 to one count of theft in office and was sentenced to 18 months of probation
    - Ordered to repay the stolen money

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74

74

## Pocketed Payments Cont.

- Belmont County – David Smith
  - Stole \$24,467
    - Former mayor, had proceeds from mayor's court deposited into his personal account
    - Plead guilty in 2020 to one count of theft in office and conflict of interest.
    - Ordered restitution of \$24,467, plus the cost of an audit – \$2,467. Also sentenced to 36 months incarceration for theft in office and 6 months for conflict of interest (to run concurrently)



75

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## Check Substitute Scheme

- Arlington Heights Mayor's Court – Donna Covert & Laura Jarvis (mother and daughter)
  - Stole \$260,000
    - Processing payments for fines, costs, and bonds, resulting in a shortage between collections and deposits
    - Covert pled guilty in 2013 and Jarvis in 2015 to one count of theft in office and were sentenced to one year and to nine months in prison
    - Ordered to repay the stolen money



76

76

## Check Substitute Scheme Cont.

- Hillsboro City School District – Pam Ward
  - Stole \$6,548
    - Doctored financial records, failing to deposit lunch money collected
    - Plead guilty in 2012 to one count of theft in office and was sentenced to five years of probation
    - Ordered to repay the stolen money

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77

77

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**About Weltman**

78

## About Weltman

- Nationally-recognized full service creditors' rights firm
- We represent creditors in:
  - Real estate default matters
  - Bankruptcy
  - Consumer and commercial collections
  - Commercial litigation
  - Municipal debt collections
    - Tax
    - Utility
    - Nuisance
    - Property damages



79

79

## About Weltman

- We strictly adhere to compliance and security standards, with a premium on reputation management.
- To learn more about our leadership in accounts receivable management, visit [weltman.com](http://weltman.com).



80

80



Questions?



Please feel free to contact me anytime:



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81