

FRAUD INVESTIGATION REPORT

Investigation Summary

On December 9, 2013, the Department's internal audit manager notified our Office regarding a potential loss of public funds, as required by state law.

The Department conducted an investigation into the matter and determined that a violation of Department policies did occur at the Larch Corrections Center equipment maintenance shop, which led to an estimated loss to the state of approximately \$63,000 between July 1, 2011 and November 30, 2013. We have reviewed the Department's investigation and agree with the conclusions. We performed additional procedures to address risks identified during our review.

The Department shared the results of its investigation with the state Executive Ethics Board. We will refer this case to the Clark County Prosecuting Attorney's Office for any further action it determines is necessary.

Background and Investigation Results

Two equipment technicians at a Department of Natural Resources equipment maintenance shop located at Larch Corrections Center failed to follow state law and Department policy by procuring parts from a vendor that was not on the state's master contract, making questionable parts purchases and exceeding their purchasing authority on multiple occasions without supervisory approval. The Department discovered the issue during a routine audit and conducted an internal investigation, which is summarized below. As a result of the allegations, the two employees were placed on home assignment and subsequently resigned. They have been employed by the Department since 1980 and 1982, respectively.

The Department, located in Thurston County, operates nine shops throughout the state, which provide maintenance and repairs for vehicles and heavy duty equipment. In fiscal year 2013, the Department maintenance shops spent almost \$4.8 million in repairs for vehicles and heavy duty equipment.

The Department's investigation focused on the purchasing history and inventory procedures at the Larch Corrections Center from July 2011 to November 2013. The investigation revealed the following:

- *Overpayment for goods procured from nonauthorized vendor.*

From July 1, 2011 to November 30, 2013 the technicians purchased \$210,301 of parts and services from a nonauthorized parts vendor. A sample of invoices from the vendor totaling \$10,426 was selected for examination. The internal investigation revealed that the state overpaid by approximately \$2,522 by not purchasing from a vendor on the state's master contract. Based on the purchase volume over the examination period, the

internal investigation concluded that the state likely overpaid by an estimated \$51,000 for the inventory items purchased from the nonauthorized parts vendor.

Additional inquiries were made to determine whether a personal relationship exists between the two employees and the vendor. No indication of inappropriate relations was found; however, subsequent inquiries revealed that the two employees knew the sales person who had previously worked at a different, state approved vendor but began working for the competitor sometime in 2011.

- *Questionable Part Purchases*

An analysis of the maintenance records identified 20 vehicles with notably higher cost of maintenance as compared to other repair shops. Further examination by the Department's internal audit function revealed \$11,712 in questionable parts purchases that appeared excessive, unnecessary and/or inconsistent with the type of vehicle or maintenance frequency schedule. Upon further review of the supporting documentation, we discovered an additional \$692 in parts not included in the original total bringing the questioned purchases total to \$12,404.

- *Exceeding Purchase Authority without Required Supervisory Approval*

The investigation also revealed that the two technicians exceeded their purchase authority 137 times during the examination period without usually obtaining the required supervisory approval by requesting separate invoices from the vendor and charging the purchases to multiple purchase orders. This was in violation of Department policy, which sets the purchase authority for equipment technicians to \$1,500 for light fleet and \$2,500 for heavy duty equipment.

In order to determine if any additional losses occurred, we examined requested invoices from the vendor for years 2011, 2012 and 2013. We reviewed the invoices to identify the amount of credits issued during the period. We also spoke to vendor staff who confirmed that refunds for items returned were credited to the Department's account except for a single refund of \$264 paid by check. We verified with the Department that the check was received.

Control weaknesses

Internal controls at the Department were not adequate to safeguard public resources. We found the following weaknesses allowed the loss to occur:

- The Department does not have an effective control in place to ensure payments are only made to vendors listed on the state's master contract.
- The Department did not follow its established inventory procedures and failed to account for all stock items. The immediate supervisor did not perform an adequate review of the

facility and did not ensure that all items are recorded in inventory. A walk-through of the Larch Corrections Center revealed 4,616 stock items that were not in the Department inventory.

- The immediate supervisor did not review work orders to ensure that the technicians did not exceed their purchase authority.
- Appropriate inventory levels were not set as required by department policy making it more difficult to identify the purchase of excessive quantities of inventory.

Recommendation

We recommend the Department strengthen internal controls over purchasing and inventory. Specifically, inventory counts should be conducted periodically and reconciliation to the financial records should be made. Discrepancies should be promptly investigated.

Inventory purchases should be reviewed by a supervisor and, if possible, by a person independent of the purchasing function who is knowledgeable of the types of activities for which inventory is purchased and can assess the reasonableness of the type of items purchased.

Inventory stock levels should be established and compared against actual purchases to ensure adequate oversight and monitoring to safeguard public resources and compliance with Department policies.

A sample of vehicle maintenance records should be reviewed periodically by someone with the appropriate technical knowledge to identify parts or repairs that appear excessive or inappropriate.

The Department should also establish safeguards to ensure that only purchases from authorized vendors are paid unless an exception is granted by a supervisor.

We also recommend the Department consider recovering the losses and related investigation costs of \$5,340 from the former equipment technicians and/or Office of Risk Management, Department of Enterprise Services, as appropriate. Any compromise or settlement of this claim by the Department must be approved in writing by the Attorney General and State Auditor as directed by state law (RCW 43.09.330). Assistant Attorney General Matt Kernutt is the contact person for the Attorney General's Office and can be reached at 360-586-0740 or mattk1@atg.wa.gov. The contact for the State Auditor's Office is Deputy Director of Local Audit Sadie Armijo, who can be reached at (360) 676-2165 ext. 108 or Sadie.Armijo@sao.wa.gov.

Department's Response

The Department of Natural Resources (DNR) would like to thank the State Auditor's Office for their work on this special report. We appreciate their thoroughness and professionalism as we worked together to address these actions.

We concur with the findings and agree with the auditor's recommendations.

Since discovery of the loss, DNR has strengthened internal controls, including centralized review and accountability of repair operations and activities.

State Auditor's Office Remarks

We thank Department officials and personnel for their thorough investigation and for their timely assistance and cooperation with our review.