

FRAUD INVESTIGATION REPORT

Investigation Summary

In December 2015, our Office learned through the media of a potential loss of public funds at the Authority. The Authority's Board members said they were not aware that state law requires governments to notify the State Auditor's Office of a potential loss of public funds. The Board President subsequently filed a report with our Office.

The Authority filed a report with the Pasco Police Department, which investigated the case. We will provide this report to the Franklin County Prosecuting Attorney's Office, which is currently handling the prosecution of this case.

We investigated and identified misappropriations totaling \$143,242 and questionable expenditures totaling \$30,456 between August 2013 and November 2015. We also identified penalties totaling \$54,765 that have been assessed to the District. The table below shows the misappropriated and questionable amounts by category.

Summary of results		
Area of investigation	Misappropriation	Questionable
Cash receipts	\$44,724	\$0
General disbursements	\$48,321	\$19,543
Payroll	\$30,742	\$5,268
Credit card	\$16,148	\$5,645
Assets	\$3,307	\$0
TOTAL	\$143,242	\$30,456

Background and Investigation Results

The Authority operates on an annual budget of about \$250,000, including \$240,000 in annual expenditures. The Authority was formed by the City of Pasco to revitalize and increase the economic vitality of downtown Pasco. The Authority has many programs aimed at helping revitalize the downtown area and creating opportunities for economic and community growth. The Authority is governed by a nine-member board appointed by the City. The Authority employs an Executive Director to oversee and manage daily operations, including; cash handling, accounts payable and receivable, payroll, reconciliation of all Authority financial

accounts and financial reporting to the Board. In addition, two managers are employed to oversee the Pasco Specialty Kitchen (the Kitchen) and Pasco Farmers Market (the Market) operations. These positions report to the Executive Director.

In November 2015, various vendors notified the Board President that they had not been paid for services rendered to the Authority. The Internal Revenue Service also contacted the Board President regarding payment concerns. Some accounts were months overdue, and had incurred penalties and interest fees for lack of proper payment. Authority payroll tax payments were in arrears since September 2013.

On November 17, 2015, the Board President requested a meeting with the former Executive Director. The former Executive Director said he couldn't meet. The Board President further researched the concerns and contacted the Pasco Police Department. On December 1, 2015, a Detective from the Pasco Police Department interviewed the former Executive Director. During the interview the former Executive Director acknowledged personally using Authority funds inappropriately. He explained funds were used to pay for child support, a personal electric bill, a trip home to New Jersey to see his children, groceries, a furniture bill, and odds and ends. He stated, "I wasn't able to catch it up."

In December 2015, the Pasco Police Department seized all Authority records as evidence. On January 5, 2016, the former Executive Director pleaded guilty in Franklin County Superior Court to taking at least \$90,000 over a two-year period.

In July 2016, seized records were released back to the Authority. We reviewed all Authority records focusing on cash receipting, general disbursements, payroll and credit card charges related to the Authority, the Kitchen and the Market. In addition, we reviewed grant funds and general operation funds given by the City of Pasco to the Authority, and determined these all were deposited into the Authority's bank accounts. However, we found issues in the following areas:

Cash Receipting

The Authority has four main revenue sources, including:

1. The City, which gives the Authority a monthly operational disbursement.
2. The Kitchen, which is a certified commercial kitchen for local entrepreneurs. Local food businesses may rent the Kitchen for \$12-18 an hour. The Kitchen also receives a federal grant, which the City manages.

We were able to match all funds paid from the City of Pasco to the Authority's bank deposit records. The Kitchen's Manager maintained detailed bank deposit records, which we compared to Authority bank deposit records. From January 2013 to July 2013, we were able to tie Kitchen bank deposit records to Authority bank deposit records without any differences

noted. During this time, the Kitchen Manager handled the bank depositing. Beginning in August 2013, after the former Executive Director was hired and started making some of the deposits, Kitchen bank deposit records do not match Authority bank deposit records. The table below summarizes the Kitchen's receipt records less money provided by the City; City-provided money is subtracted because deposit records for that money matched actual Authority bank deposit records without exception.

Year	Kitchen receipt records	Authority bank deposit records	Variance
2013	\$48,887	\$48,887	\$0
2014	\$49,983	\$44,980	(\$5,003)
2015	\$36,970	\$35,781	(\$1,189)
Total	\$135,840	\$129,648	(\$6,192)

We identified \$6,192 of Kitchen revenue in 2014 and 2015 that we could not match to Authority bank deposit records.

3. The Market is an outlet for local farmers to direct-sell their farm fresh products. Vendors wishing to sell their products pay an annual permit fee ranging from \$50 to \$100. The Market operates Wednesdays and Saturdays, May through October. On each day the Market operates, the Market Manager completes a log of vendors present at the market, marking which stall the vendor occupies. When the Market closes for the day, the Market Manager collects daily rent payment from each vendor (\$15 for Wednesdays and \$30 for Saturdays). The Market Manager completes a receipt for vendor payment on a pre-numbered carbon-copy receipt. The white copy is provided to the vendor, and the yellow remains with the farmer's market. The Market Manager gives all collected vendor payments to the former Executive Director to deposit at the bank. We reviewed the Authority's yellow receipt records and vendor map documentation from 2013 to 2015 and found \$85,885 in documented Market revenue that did not match Authority bank deposit records.

Year	Market receipt records	Authority bank deposit records	Variance
2013	\$37,935	\$21,775	(\$16,160)
2014	\$40,020	\$1,710	(\$38,310)
2015	\$31,415	\$0	(\$31,415)
Total	\$109,370	\$23,485	(\$85,885)

4. The Authority also holds special events throughout the year and receives public donations. Vendors pay for sponsorships and advertising at the special events. The former Executive Director receipted these payments for the Authority. Supporting documentation for these revenues was limited. We were able to locate some records from Authority files and the accounting system to estimate expected special events revenues for 2014 and 2015. Revenues for each year were estimated to be \$55,330.

We compared overall expected Authority revenues when all revenue sources (the Kitchen, the Market and special events) are combined to actual bank deposit records. We did this because during our review of each revenue source area, we identified not only discrepancies between receipted funds and actual deposits but also instances of additional deposits that could not be explained or traced to any receipt records. Therefore, when we compare all expected revenue to actual revenue deposited, we estimate a total loss of \$44,724 in Authority revenues. This is a conservative estimate due to the condition of records retained at the Authority, which limited our ability to completely assess the full extent of the lost revenue.

Year	Total expected revenue	Actual revenue deposited	Difference
2013	\$215,442	\$216,461	\$1,019
2014	\$286,096	\$261,605	(\$24,491)
2015	\$263,002	\$241,750	(\$21,252)
Total	\$764,540	\$719,816	(\$44,724)

General Disbursements

The former Executive Director was responsible for preparing, recording in the accounting system, and authorizing checks for all Authority disbursements. A secondary signature by either the Board President or one other backup Board Member is required for all Authority checks. The former Executive Director was also responsible for:

- Handling all data entry into the accounting system of all Authority revenues, expenses, payroll, and making any needed adjustments
- Retaining supporting documentation for Authority revenues and expenditures
- Reconciling all Authority financial accounts
- Giving the Board a monthly profit-and-loss statement

During our review of Authority files, we did not locate most of the supporting documentation for expenditures from about July 2013 to December 2015. We obtained and reviewed copies of all the Authority's bank statements from their contracted CPA firm.

We summarized payments to vendors and performed a trend analysis by year, from 2012 to 2015, of vendors paid before and during the former Executive Director's employment. Using this information, we identified questionable vendor disbursements for further review. We sent subpoena requests to some of the vendors and reached out to others directly to obtain receipted payment information from their records. We also selected a sample of questionable checks and obtained from the bank copies of the back of each cleared check for further review.

Based on our review of general disbursements, we identified \$48,321 in misappropriated disbursements out of Authority bank accounts made by the former Executive Director from October 2013 through November 2015. A majority of the misappropriated disbursements

(\$29,221) were completed using the bank issued debit card in the former Executive Director's name. The Board was not aware the Executive Director had obtained a bank debit card in his name. Misappropriated disbursements included the following items:

- \$17,103 in bank cash withdrawals
- \$11,481 in disbursements to a check-into-cash vendor
- \$3,666 in personal cell phone expenses to a vendor not used by the Authority
- \$2,266 related to personal utility account payments including electric and water
- \$2,145 for out of state travel expenses, including airfare, taxi fares and meals

We also identified \$19,543 in questionable disbursements. This includes \$2,990 in automatic bank transfers to a vendor identified as Pasco Downtown Development, however, according to the Authority's Board Treasurer this is an old entity that closed in 2010. There should be no funds disbursed to this vendor. In addition, during our review of Authority files, we located falsified bank statements for all of 2014 on an Authority USB flash drive maintained by the former Executive Director. Bank deposits, withdrawals and account balances were adjusted. In some instances, child support disbursements and deposit information were removed.

Payroll

The former Executive Director was responsible for preparing, recording within the accounting system, calculating payroll withholdings for and authorizing Authority payroll checks, including his own. The former Executive Director was also responsible for handling any related payroll correspondence with outside agencies. On a quarterly basis, the former Executive Director would provide the Authority's contracted CPA firm with payroll information from their accounting system to prepare the quarterly payroll tax reporting information and payment amounts.

An offer letter dated July 5, 2013, was accepted by the former Executive Director with a starting annual salary of \$52,000, plus a monthly \$200 health stipend. We used the Authority's bank statements to identify all disbursements paid directly to the former Executive Director. We cross referenced this information with gross compensation documented in the Authority's accounting system records. We also used reported child support payment information to compare with Authority records.

Based on the records reviewed, we determined the former Executive Director was compensated a total of \$120,459 from August 2013 to November 2015, which includes \$1,917 related to a health stipend. We also identified \$11,481 in disbursements to a check-into-cash vendor that

were likely payroll-related disbursements to the former Executive Director. These were considered misappropriation and included in the general disbursements loss figures. We compared actual net check payments to the former Executive Director based on bank statements to expected net check payments based on gross wages, less tax withholdings and child support payments confirmed disbursed. We identified the following discrepancies by year:

Year	Expected net check	Actual net check	Misappropriated
2013	\$19,818	\$19,818	\$0
2014	\$20,960	\$40,878	(\$19,487)
2015	\$18,602	\$29,857	(\$11,255)
Total	\$59,380	\$90,553	(\$30,742)

The payroll misappropriation totals \$30,742 between 2014 and 2015. The misappropriated amounts related directly to the following two items:

- \$28,138 related to the former Executive Director's child support payments not properly withheld from his payroll checks but instead paid using Authority funds
- \$2,604 related to duplicated payroll checks that were prepared and cashed by the former Executive Director for pay periods that had already been compensated for

During our review of Authority files, we located a document discussing a \$600 fine to the Authority for failure to disburse child support funds considered collected by the Authority from the former Executive Director's payroll. This fine was based on a paystub submitted for the former Executive Director from May 2015. The pay period referenced May 16 through May 31, 2015. The pay stub reflected the former Executive Director's total net check for that period was \$890.33 and child support \$890.33 was withheld. We reviewed the Authority's bank statement and cleared check for this pay period and found the records provided as support were falsified. The check actually cashed by the former Executive Director for this pay period totaled \$1,780.66, which was not less the child support withholding.

We also identified \$5,268 in questionable disbursements directly to the former Executive Director; however, we did not locate any supporting documentation to explain the purpose of these disbursements or if they were payroll related.

Credit Cards

A credit card under the Authority's account was issued to the former Executive Director in his name beginning in August 2013 with an available credit limit of \$1,500. Monthly credit card statements summarizing charges and payment amounts due were mailed to the former Executive Director who was responsible for making payments, maintaining supporting documentation for charges and reconciling the statement.

We reviewed all credit card statements for the former Executive Director's card from August 5, 2013, through December 22, 2015, and identified a total misappropriation of \$16,148 and questionable charges of \$5,645. We found the former Executive Director spent \$5,227 in personal airline-related expenses to travel out of state multiple times from 2013 to 2015, and also paid \$5,535 in legal fees to an out of state law firm. Other charges identified included:

- \$573 personal rental car
- \$485 personal music and radio services
- \$440 in fuel charges with some occurring out of state
- \$436 personal networking and credit monitoring expenses
- \$419 in out of state restaurant expenses

Assets

While reviewing Authority disbursements and limited records, we identified three assets purchased by the former Executive Director that are not in the Authority's possession. These included:

- A flat-screen television, with total payments of \$2,462 made. We identified in Authority records a copy of a lease-to-own agreement in the former Executive Director's name for a flat-screen television with a total cash price purchase of \$2,645.
- A 13.3-inch touch screen laptop, which the former Executive Director purchased for \$465.68 using an Authority check.
- An electronic notebook and wireless mouse totaling \$379.04, which the former Executive Director bought with the credit card in August 2013.

Penalties

The former Executive Director's management of Authority operations caused various other issues for the Authority, including:

- Overdue payroll taxes, which as of December 2015 totaled \$59,397. Penalties and interest as of September 14, 2016, totaled \$29,594. According to IRS records, the Authority had not paid payroll taxes since September 2013. The contracted CPA firm prepared Authority quarterly payroll tax reporting information, but it was the former Executive Director's responsibility to prepare and disburse the appropriate payment amount.
- \$34,611 in bank-assessed fees that were applied to Authority accounts because of non-sufficient funds when a vendor tried to cash a receipted check from the Authority prepared by the former Executive Director. During our review of Authority bank account disbursements, we identified a total of \$141,140 in checks that were returned because of non-sufficient funds in Authority accounts from 2014 through 2015.
- During review of the former Executive Director's credit card, we identified \$736 in late payment and interest fees applied to the account, because of the former Executive Director not making timely payments.

Control Weaknesses

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

- A secondary review of all Authority bank accounts was not performed. The former Executive Director maintained complete control over these accounts, including reconciliation.
- Cash receipting controls were not adequate to ensure funds receipted were deposited in a timely manner and in the payment form originally received.
- Payments, including those for payroll, were not scrutinized in sufficient detail to detect concerns.
- A secondary review of the former Executive Director's credit card was not performed. Credit card statements were mailed directly to the former Executive Director, and he was responsible for payment and reconciliation to supporting documentation.
- Many supporting disbursement documents were not retained to validate Authority expenditures.

Recommendations

We recommend the Authority strengthen internal controls over all key system operations to ensure adequate oversight and monitoring to safeguard public resources and compliance with Authority policies. This should include:

- A secondary review over all Authority bank accounts by someone independent of the cash receipting and payment processes. Reviews should include spot checking original cash receipting documentation for comparison to bank deposit records. Reviews should also include a complete review of all payments and support.
- Maintaining public records to comply with state law.
- Monitor the entries into the accounting software. For example, work with the software provider to have an accounting system adjustment or audit trail report available for periodic reviews by someone independent of adjustments entered into the system.

We also recommend the Authority seek recovery of the misappropriated \$143,242, questionable transactions, as appropriate, and related investigation costs of \$31,753 from the former Executive Director and/or its insurance bonding company. Any compromise or settlement of this claim by the Authority must be approved in writing by the Attorney General and State Auditor as directed by state law (RCW 43.09.260). 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 Sadie Armijo, Deputy Director of Local Audit, who can be reached at (360) 902-0362 or Sadie.Armijo@sao.wa.gov.

Authority's Response

It is the intention of the Authority to perform a review of our control environment, risk assessment process, control activities, information and communication systems, and our monitoring.

Examples of the above include: board of directors setting the tone for financial reporting expectations, identify areas where segregation of duties can be utilized, implement controls of income and expense documentation, adequate bookkeeping, and improved monitoring.

The Authority thanks the Washington State Auditor's Office for their diligence and professional approach in assisting us with our fraud investigation.

State Auditor's Office Remarks

We thank Authority officials and personnel for their assistance and cooperation during the investigation.